

Trustee's Obligation to Inform Beneficiaries: Avoiding Breach of Fiduciary Duty Claims

Reconciling Discrepancies Between Trust Document and State Law, Navigating State Statutes and UTC Provisions

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A Trustee's Duty To Inform Beneficiaries: Avoiding Breach of Fiduciary Duty Claims

David F. Johnson and Scott E. Rahn

Introduction

- Trustees possess, manage, and control assets for beneficiaries – usually for compensation.
- This is significant authority and power.
- There are many corresponding duties: one of the most important duties is the duty to disclose information and a beneficiary's right to information.

Introduction

- Bogert, Trusts & Trustees, Second Edition Revised, §961 explains the reason for this duty as follows:
 - “The beneficiary is the equitable owner of the trust property, in whole or in part. The trustee is a mere representative whose function is to attend to the safety of the trust property and to obtain its avails for the beneficiary in the manner provided by the trust instrument. That the settlor has created a trust and thus required that the beneficiary enjoy his property interest indirectly does not imply that the beneficiary is to be kept in ignorance of the trust, the nature of the trust property and the details of its administration. If the beneficiary is to be able to hold the trustee to proper standards of care and honesty and to obtain the benefits to which the trust instrument and doctrines of equity entitle him, he must know of what the trust property consists and how it is managed.”

Introduction

- This presentation will address:
 - A trustee's duty to inform and a beneficiary's right to information at common law and under the Uniform Trust Code;
 - The trustee's duty to account and responding to request for accountings;
 - Silent or quiet trusts;
 - Avoiding claims for breach of fiduciary duty; and
 - Potential remedies for breaches of duty.

Sources For Duty To Disclose

- There are four independent sources for a duty to disclose:
 - The Trust Document;
 - State Statutory Law;
 - Common Law; and
 - Litigation Rules.

Trust Document's Duty To Disclose

- A trust document may have express provisions regarding the disclosure of information to beneficiaries that are more onerous than statutory or common law.
- Generally, the trust document governs and should be followed. UTC 105 (“*Except as otherwise provided in the terms of the trust, this [Code] governs the duties and powers of a trustee, relations among trustees, and rights and interests of a beneficiary.*”).
- If a trust instrument provides additional disclosure requirements, a trustee should follow them or else risk a breach of duty claim.

Trust Document's Duty to Disclose

- In *Alpert v. Riley*, the trusts required the trustee to notify the beneficiaries annually of their right to withdraw an amount equal to the aggregate amount contributed by each donor for that calendar year or \$20,000, whichever is less. 274 S.W.3d 277 (Tex. App.—Houston [1st Dist.] 2008, pet. denied).
- Based on the terms of the trust, the court concluded that a rational trier of fact could conclude that the trustee breached his fiduciary duty by failing to communicate the amount the beneficiaries could withdraw.

Trust Document's Duty To Disclose

- Can a settlor limit disclosure obligations?
- A settlor may limit disclosure obligations in a revocable trust – the settlor can always revoke it or change beneficiaries.
- Some limited precedent in other jurisdictions that would support a duty to disclose to beneficiaries in revocable trust situations.
- Also, duty may arise if the settlor becomes incompetent.
- However, in an irrevocable trust, statutes generally limit what a settlor can do regarding limiting the duty of disclosure.

Trust Document's Duty To Disclose

- UTC 105(b)(8) states that a trust cannot limit a trustee's duty to notify qualified beneficiaries of an irrevocable trust who are 25 of the existence of the trust, the identity of the trustee, their right to request trustee's reports.
- This provision allows settlors to limit disclosure obligations to young beneficiaries.
- However, this provision does not distinguish between the type of interest of the beneficiaries.
- Some states do take into account the beneficiaries' interest (contingent, etc.).

Trust Document's Duty To Disclose

- UTC 105(b)(9) states that a trust cannot limit the duty to respond to a request for reports and other information reasonably related to the administration of the trust.
- If a young beneficiary learns of the trust, the trustee must make disclosures.

Trust Document's Duty To Disclose

- Other than these exceptions, a settlor may restrict or eliminate the duty to disclose or the beneficiary's right to information.
- Example: beneficiaries under 25 and, in some states, contingent remainder beneficiaries.
- Accordingly, a trustee should carefully review a trust document to see if there are any changes regarding the duty or right to disclose.

Statutory Duty to Disclose

- After reviewing the trust document, a trustee should be aware of statutory duties of disclosure.
- UTC 813(a) provides: “A trustee shall keep the qualified beneficiaries of the trust reasonably informed about the administration of the trust and of the material facts necessary for them to protect their interests.”
- UTC 103(12) provides: “Qualified beneficiary” means a beneficiary who, on the date the beneficiary’s qualification is determined:
 - (A) is a distributee or permissible distributee of trust income or principal;
 - (B) would be a distributee or permissible distributee of trust income or principal if the interests of the distributees described in subparagraph (A) terminated on that date; or
 - (C) would be a distributee or permissible distributee of trust income or principal if the trust terminated on that date.

Statutory Duty to Disclose

- UTC 813(a) further states: “[u]nless unreasonable under the circumstances, a trustee shall promptly respond to a beneficiary’s request for information related to the administration of the trust.”
- This provision provides a different standard if a beneficiary, whether qualified or not, makes a request for information. In that event, the trustee must promptly comply with the beneficiary’s request unless unreasonable under the circumstances.

Statutory Duty to Disclose

- UTC 813(b) provides that:
 - (1) upon request of a beneficiary, shall promptly furnish to the beneficiary a copy of the trust instrument;
 - (2) within 60 days after accepting a trusteeship, shall notify the qualified beneficiaries of the acceptance and of the trustee's name, address, and telephone number;

Statutory Duty to Disclose

- (3) within 60 days after the date the trustee acquires knowledge of the creation of an irrevocable trust, or the date the trustee acquires knowledge that a formerly revocable trust has become irrevocable, whether by the death of the settlor or otherwise, shall notify the qualified beneficiaries of the trust's existence, of the identity of the settlor or settlors, of the right to request a copy of the trust instrument, and of the right to a trustee's report as provided in subsection (c); and
- (4) shall notify the qualified beneficiaries in advance of any change in the method or rate of the trustee's compensation.

Statutory Duty To Disclose

- UTC 813(d) provides: “A beneficiary may waive the right to a trustee’s report or other information otherwise required to be furnished under this section. A beneficiary, with respect to future reports and other information, may withdraw a waiver previously given.”
- However, a waiver of a trustee’s report or other information does not relieve the trustee from accountability and potential liability for matters that the report or other information would have disclosed.

Statutory Duty to Disclose

- CA Probate Code 16060. The trustee has a duty to keep the beneficiaries of the trust reasonably informed of the trust and its administration.
- CA Probate Code 16060.7. On the request of a beneficiary, the trustee shall provide the terms of the trust to the beneficiary unless the trustee is not required to...
- 16061.5 Defines “terms of the trust.”

Statutory Duty to Disclose

- CA Prob Code 16061. ...on reasonable request by a beneficiary, the trustee shall report to the beneficiary by providing requested information to the beneficiary relating to the administration of the trust relevant to the beneficiary's interest.
- CA Prob Code 16061.5 details who is entitled to the terms of an irrevocable trust.

Statutory Duty to Disclose

- CA Probate Code 16061.7. Trustee notification to beneficiaries and heirs: “You may not bring an action to contest the trust more than 120 days from the date this notification by the trustee is served upon you or 60 days from the date on which a copy of the terms of the trust is delivered to you during that 120-day period, whichever is later.”
- Served within 60 days of irrevocability.

Statutory Duty to Disclose

- CA Probate Code 16061.8. No person upon whom the notification by the trustee is served may bring an action to contest the trust more than 120 days from the date the notification by the trustee is served upon him or her, or 60 days from the date on which a copy of the terms of the trust is delivered during that 120-day period, whichever is later.

Statutory Duty to Disclose

- CA Probate Code 16061.9. A trustee who fails to provide 16061.7 notice shall be responsible for all damages, attorney's fees, and costs caused by the failure unless the trustee made a reasonably diligent effort to comply.
- A trustee may delay distribution of trust assets if the contest period has not expired.

Demand for Accounting

- UTC 813(c) provides:
 - A trustee shall send to the distributees or permissible distributees of trust income or principal, and to other qualified or nonqualified beneficiaries who request it, at least annually and at the termination of the trust, a report of the trust property, liabilities, receipts, and disbursements, including the source and amount of the trustee's compensation, a listing of the trust assets and, if feasible, their respective market values.
 - Upon a vacancy in a trusteeship, unless a cotrustee remains in office, a report must be sent to the qualified beneficiaries by the former trustee. A personal representative, [conservator], or [guardian] may send the qualified beneficiaries a report on behalf of a deceased or incapacitated trustee.

Demand for Accounting

- The UTC employs the term “report” instead of “accounting” in order to negate any inference that the report must be prepared in any particular format or with a high degree of formality.
- The reporting requirement might even be satisfied by providing the beneficiaries with copies of the trust’s income tax returns and monthly brokerage account statements if the information on those returns and statements is complete and sufficiently clear.
- The key factor is not the format chosen but whether the report provides the beneficiaries with the information necessary to protect their interests.

Demand for Accounting

- For example, in *In re Goar*, a beneficiary complained that a trustee did not provide an adequate statutory report. 2012 Ariz. App. Unpub. LEXIS 1541 (Ct. App. Ariz. December 31, 2012).
- The court held that the trustee's trust statements were sufficient to comply with the statutory report requirement:
 - “Contrary to Myers’s assertion, Bossé’s proposed trust distribution meets the reporting requirements of § 14-10813(C). The document provides detailed information about the trusts; the assets held therein and their respective values; the previous and proposed distributions; and a holdback for administrative expenses. In addition, Bossé attached to that document a recent account statement listing the trust assets with more specificity and reflecting the income, deposits, withdrawals, expenses, purchases, and sales. The proposed distribution submitted by Bossé thus includes the ‘receipts and disbursements’ that Myers had specifically requested.”

Demand for Accounting

- A beneficiary may simply be impossible to please, no matter the accountings and disclosures given.
- Repeated and detailed requests for accountings can be a substantial cost to the trust – a cost that may impact other beneficiaries.
- Accordingly, a trustee should consider the cost in responding to difficult beneficiaries.
- Further, a trustee may seek protection from a court via a declaratory judgment suit from unreasonable requests for information.

Demand for Accounting

- States typically have statutes that provide that a court has jurisdiction to review an accounting and settle interim or final accounts.
- These provisions allow trustees to file suits for a final accounting and judicial discharge.
- These proceedings can typically be avoided if the beneficiaries will sign an adequate receipt, release, and refunding agreement.

Demand for Accounting

- CA Probate Code 17200. A trustee has 60 days to account in response to a beneficiary demand.
- If the trustee fails to do so, then you may petition the probate court for an order compelling the trustee to account.
- A beneficiary may not petition the court if they have not demanded an accounting.

Demand for Accounting

- CA Probate Code 16062. Trustee shall account at least annually, at the termination of the trust, and upon a change of trustee, to each beneficiary to whom income or principal may be distributed.
- Some limited ability for trustors to waive accounting obligation, but the courts are always going to order trustees to account.

Demand for Accounting

- CA Probate Code 16063. An accounting must include: receipts, disbursements, assets, liabilities, trustee compensation, agent compensation.
- Must disclose that the recipient may seek court review of the acts of the trustee
- Must advise that claims for breach of trust may not be made after three years from the date the report is received.

Common-Law Duty To Disclose

- At common law, “trustees and executors have a fiduciary duty of full disclosure of all material facts known to them that might affect [the beneficiaries’] rights.” *Huie v. DeShazo*, 922 S.W.2d 920 (Tex. 1996).
- The breach of the duty of full disclosure by a fiduciary is tantamount to fraudulent concealment.
- The existence of strained relations between parties does not minimize the fiduciary's duty of full and complete disclosure.

Common-Law Duty to Disclose

- Does a plaintiff have to have expert testimony to prove a breach of a duty to disclose?
- No. In *Wells Fargo Bank, N.A. v. Crocker*, the court held:
 - “We cannot conclude that expert testimony is necessary to establish a breach of this simple and straightforward duty. The disclosure of details concerning the Crocker sisters' interest in their father's estate, including the \$ 230,000 from the disputed account, is not outside the common experience and understanding of the average layman. An expert was not required to testify that Wells Fargo, having the fiduciary duty to disclose material facts, should have disclosed information to the beneficiaries concerning the disputed account.”
- No. 13-07-00732-CV, 2009 Tex. App. LEXIS 9791 (Tex. App.—Corpus Christi December 29, 2009, pet. denied).
- Further, testimony from an attorney/expert on the scope of a duty to disclose may be inadmissible.

Common-Law Duty To Disclose

- The specific information that should be disclosed may vary depending on the terms of the trust, state law, and other factors such as the nature of the beneficiary's interest, age, capacity, and sophistication, the nature of the trust assets and transactions, and the identity of the trustee.
- Disclosure may include the trust instrument, information about the trustee, trustee compensation, conflicts-of-interest, expenses, trust assets and investment policies or strategies, performance, liabilities, receipts, disbursements, discretionary actions by trustee, tax matters, and other items.

Common-Law Duty To Disclose

- Is there an affirmative duty to disclose?
- Yes and no.
- There is a duty to affirmatively disclose certain matters, such as conflicts-of-interest, fiduciary breaches, or information that a trustee has that may significantly impact a beneficiary's interest.
- However, there may not be a duty to disclose routine trust activities. See Restatement (Third) Trusts, §82(1)(b), cmt. d.

Common-Law Duty To Disclose

- The Restatement (Third) of Trusts, Section 82(1) provides that a trustee has a duty to:
 - Promptly inform beneficiaries of the existence of the trust, their right to obtain further information, and basic information concerning the trusteeship;
 - Inform beneficiaries of significant changes in their beneficiary status; and
 - Keep beneficiaries reasonably informed of changes involving the trusteeship and about other significant developments concerning the trust and its administration, particularly material information needed by beneficiaries for the protection of their interests.

Common-Law Duty To Disclose

- Who is entitled to disclosure?
- Certainly, any active beneficiary that currently may receive a distribution is entitled to information.
- Whether remote beneficiaries are also entitled to information is not entirely clear.
- Once again, the UTC would seem to indicate that remote beneficiaries are entitled to information absent a trust provision to the contrary.
- Restatement (Third) of Trusts, Sec. 82 cmt. a(1) would indicate that disclosure to remote beneficiaries is not required.

Common-Law Duty To Disclose

- What if the beneficiary has capacity issues?
- The Restatement of Trusts Section 82 is very helpful and provides as follows:
 - “A duty to provide information to a beneficiary who is under a disability may be satisfied for purposes of Subsection (1), by providing the information to the beneficiary’s conservator, agent under a durable power of attorney, legal or natural guardian, or other suitable person(s), such as one or more trust beneficiaries whose concerns can be expected reasonably to coincide with those of the disabled beneficiary.”

Common-Law Duty To Disclose

- A trustee may not have a duty to disclose:
 - Non-material facts;
 - Facts about a trustee's non-trust related activities;
 - Negotiations concerning the purchase or sale of trust assets (if disclosed, possible cure is a confidentiality agreement);
 - Private information (financial, medical, etc.) about other beneficiaries; and
 - Attorney/client communications.

Common-Law Duty To Disclose

- Where a trust owns stock or partnership interests in closely held businesses, may a beneficiary obtain access to the businesses' information?
- If the business is wholly owned by the trust?
- If the business is only partly owned by the trust?
- May set up a conflict situation for the trustee – duty to business versus duty to beneficiaries.

Common-Law Duty To Disclose

- There is a line between the actions and duties of a trustee and the actions of a representative of an entity owned all or in part by the trust even where the same person wears both hats.
- The actions of the entity representative will not be subject to fiduciary duties to the beneficiaries.
- The books and records of an entity in which a trust owns an interest may be discoverable in litigation to the extent such records are within the trustee's possession, custody, and control.

Common-Law Duty To Disclose

- A trustee is required to keep full, accurate, and orderly records concerning the status of the trust estate and all acts performed thereunder.
- A trustee has a duty, upon demand, to allow a beneficiary on a reasonable basis to inspect the non-privileged books and records of the trust. Restatement of the Law of Trusts 3rd §82.

Disclosure In Litigation

- Rules generally provide for disclosure via:
 - Requests for disclosure;
 - Requests for production (documents and things);
 - Interrogatories;
 - Depositions and pre-suit depositions;
 - Physical and mental examinations; and
 - Access to real property.

Disclosure In Litigation

- The harm in not disclosing information in litigation is that a court may sanction a party for failing to disclose when there is an obligation to do so.
- These sanctions can be severe and case dispositive.

Disclosure In Litigation

- There is an issue as to whether a trustee's common-law duty to disclose is in addition to discovery during litigation, such that a trustee only has to respond to discovery and not informal requests for information.
- Multiple authors have different views on this issue.
- The safest course is to disclose all material facts that may impact a beneficiary's interest – whether requested in discovery or via informal means.

Disclosure In Litigation

- State rules may allow a court to appoint an auditor to state the accounts between the parties and to make a report thereof to the court.
- The auditor shall verify the report via an affidavit.
- Court will award compensation to the auditor to be taxed as costs.
- Potentially, a court can appoint a limited receiver to prepare an accounting or other disclosures.

Silent Trusts

- A “silent trust” is a trust that instructs the trustee to not disclose the existence of the trust to the beneficiaries.
- Many reasons a settlor may want to create one.
- Majority of states do not allow silent trusts.
- Some states allow but with requirements that may make a silent trust cumbersome.
- While a silent trust can alleviate a trustee’s duties to provide information to a beneficiary, a trustee may not be altogether relieved of the duty to inform and report.

Silent Trust

- For example, in Ohio, the settlor must appoint a “beneficiary surrogate” to receive required notices, information, and reports on behalf of the beneficiary.
- The settlor has broad discretion in selecting a beneficiary surrogate and may select any person other than the trustee.
- The beneficiary surrogate must act in good faith to protect the interests of the beneficiary for whom the notices, information, or reports are received.
- A person who agrees to serve as beneficiary surrogate should be well-informed about the role and the risks associated with it.

Silent Trusts

- There are practical reasons why a fiduciary would not want to be involved in a silent trust.
- This creates an awkward position where a trustee is required to keep the trust a secret, which may mean it has little interaction with the beneficiaries, but may still have the discretion to make distributions where it does not know their circumstances.
- It probably increases risk of fiduciary claims.
- Trustee may need to disclose trust depending on facts, e.g., beneficiary prenuptial agreement.

Silent Trusts

- There may be reasons that the parties may want to silence a noisy trust.
- Most states allow a beneficiary to release a trustee from duties.
- Parties can also potentially file suit to modify a trust to provide limitations on a duty to disclose.
- In a revocable trust, a settlor can amend the trust document to provide limitations on a duty to disclose.

Ramifications For Failure To Disclose

- There are many potential ramifications for a trustee breaching a duty to disclose.
 - Court order requiring trustee to act.
 - Compensation forfeiture.
 - Claim for damages by beneficiaries.
 - Attorney's fees.
 - Removal of trustee.
 - SOL may be tolled.
 - Inability to rely on equitable defenses, like waiver, estoppel and ratification.
 - Rescind transactions.
 - Void releases.

Avoiding Claims

- Prepare regular statements that provide accurate picture of material facts of the trust and provide to all beneficiaries or their representatives.
- Where appropriate, copy beneficiaries on third-party reports.
- Have regular meetings with beneficiaries to discuss management of the trust.
- Document the delivery of statements and meetings.
- Provide disclosure letters on other material issues as they arise in trust administration.
- Private release agreements.
- Court orders limiting disclosure obligations.

Conclusion

- Trustees take on significant duties when they accept the position.
- One of the most important duties is the duty of disclosure.
- Due to the potentially extreme consequences for failing to meet this duty, trustees should be very cautious.
- The authors hope that this presentation was helpful in analyzing the duty to disclose.

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Q&A

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