WHAT TO DO WITH A TRUSTEE WHO DOESN'T "GET IT"

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I. BENEFICIARY OR TRUSTEE:POINTS OF CONTENTION

A. Accounts--The Trustee's Leaky Shield

The Trustee's insensitivity to, or complete ignorance of, the duty to account is often the procedural catalyst for commencing the dispute. If the trustee and the beneficiaries are close relations, accounts may not even have been prepared. Occasionally, trust instruments will contain express waivers of a trustee's duty to account. The trustee then uses this exculpatory clause to conduct administration in a lackadaisical manner, which in turn leads to beneficiary discontent.

Less egregious is the trustee who prepares periodic accounts, but does so incompletely. This incompleteness as often stems from an ignorance of the requirements as from any malevolent purpose. A trustee's ignorance is often compounded by the accountant's lack of expertise. Generally, accountants are unfamiliar with fiduciary accounting principles. A CPA is likely to treat the Probate Code requirement of following "general accounting principles" as the equivalent of using "generally accepted accounting principles" (GAAP) when the two are not the same. The trustee will also not appreciate the distinction, simply assuming that financial reports prepared by an accountant will qualify as a Probate Code accounting.

Alternately, the trustee may not even hire a professional to prepare the account. The trustee may believe that fiduciary accounting duties can be satisfied by sending a copy of the year-end brokerage statement, sometimes accompanied by a copy of the Form 1041, Fiduciary Income Tax Return. Equally frequently, the income tax return is not provided.

The salient fact in all these situations is that none of these approaches will qualify as accountings for the purpose of running the statute of limitations. Many trust instruments contain a shortened statute of limitations for trustee accounts. For example, the document may provide that a beneficiary who fails to object to an account within the stated time period, e.g. 90 days or 120 days, will be forever estopped from raising any objections. Notwithstanding the severity of this language, the author is dubious that a court would enforce such a limitation if the financial information provided fell short of what is required by the Probate Code.

An account is generally understood to be a bookkeeping system that distinguishes between principal and income. An account should also communicate sufficient detail to inform the beneficiaries of the transactions and investments of the trust.[21] The statutory requirements stem from the development of the duty at common law.[22]

A common misconception surrounds the presumptions governing an account. Trustees are under an obligation to render to beneficiaries a full account of all their dealings with the trust property and when there has been a negligent failure to keep true accounts, all presumptions are against them.[23] Trustees are also under the duty to prove every item of their account by "satisfactory evidence"; the burden of proof is on them and not on the beneficiary. Any doubt arising from their failure to keep proper records, or from the nature of the proof they produce, must be resolved against them.[24] This presumption is not limited to accounting matters. The burden is also on the trustees to establish the services rendered by them.[25]

Imposing the burden of proof on the fiduciary may strike practitioners as counter-intuitive. This shift in the burden of proof may also appear contrary to Evidence Code §530, which imposes the burden on the party seeking to prove the issue; i.e. the beneficiary objecting to the account. Nevertheless, when a fiduciary has the legal duty to allocate receipts between those in which a beneficiary has some interest and those in which the beneficiary has none, and is fully and singularly capable of making that allocation but fails to do so, the court is justified in calling on the fiduciary to bear the burden of differentiation at trial.[26]

B. Reports: The Beneficiary's Dulled Sword

The ability of a fiduciary to demand a "report" from the trustee can serve as a useful catalyst to prod a recalcitrant trustee. Prob. Code §16061 provides that a beneficiary may request a report at "reasonable" intervals. The author is unaware of any case authority defining the limits of reasonableness. Nevertheless, sensible interpretation of this requirement would imply that such reports might be requested semi-annually. This conclusion stems from the general rule that accounts are to be provided annually. A report encompasses a broader range of information, but with less specificity. Since the information requested is intended to paint a "broad-brush" picture of the trust administration, but as a "snap-shot," the beneficiary ought to be able to request this information more frequently than the annual accounts the trustee is required to provide.

Requesting a report is usually done informally. A petition to compel a report is unlikely, since a beneficiary is more likely to use a petition to compel an account. A trustee who fails to respond timely to a beneficiary's request for a report risks creating a distinctly unfavorable impression to the court in the subsequent contested proceedings. In consequence, the request for a report can serve as an effective tool for the (about-to-be) aggrieved beneficiary to determine the extent of the trustee's misconduct or mistakes.

Conversely, however, a request for a report typically will serve as a signal to the trustee that the beneficiary may be disgruntled. The cautious trustee will therefore realize that the request for a report may simply be the opening skirmish in litigation calculated to remove the trustee or to seek a surcharge on the trustee for breach of fiduciary duty. In such circumstances, the trustee should either prepare a report that can easily be revised to become an account or provide an account. The requested report would include the additional required information, which could easily be separated to become a court-filed accounting.

A prudent trustee might view the information required by a report as a useful guideline in keeping beneficiaries reasonably informed regarding the progress of trust administration. Using the report on a pre-emptive basis, therefore, can help the trustee avoid contention.

To the contrary, an oblivious or arrogant trustee may stumble into quicksand if he or she pays no attention to the information encompassed in a report or fails to provide this information in a responsive manner. The professional advisor may find it useful to alert the trustee to the requirements of Prob. Code § 16061 as a defensive measure.

C. Fiduciary Self-Dealing

A trustee's self-dealing is a surprisingly common cause of contention in trust administration. Usually the self-dealing has continued for a period of time without recognition of its risk by the trustee of knowledge of its value to the beneficiary in a subsequent dispute. The self-dealing is then seized upon by the astute lawyer seeking to obtain an advantage for the beneficiary client whose original complaints may have been directed at another ostensible administration problem.

"The trustee has a duty not to use or deal with trust property for the trustee's own profit or for any other purpose unconnected with the trust, nor to take part in any transaction in which the trustee has an interest adverse to the beneficiary."[27] Trustees often fail to appreciate that, absent an express or implied agreement, a fiduciary who breaches fiduciary duties by self-dealing may not escape liability by showing that the trustee's activities were fair to and in the best interests of the beneficiaries or other fiduciaries.[28] A trustee's self-dealing, which by definition violates the trustee's duty of loyalty, cannot be justified by the good faith of trustee or by evidence of custom and usage because a trustee may not receive any personal advantage without full disclosure to beneficiary.[29] Similarly, there can be no secret profits allowed to a trustee, inasmuch as it owes the beneficiary the duty of fullest disclosure of all material facts.[29]

Self-dealing often arises when the trustee buys or sells trust property[31] or pays himself compensation for services rendered in a non-fiduciary capacity without court or beneficiary approval. The advisor's challenge is to alert the trustee-client that *everything* a trustee does will be viewed through the filter of fiduciary duty.

D. Investments

Much has already been written about the Uniform Prudent Investor Act (*UPIA*),[32] which became effective in California on January 1, 1996. The statute is clear and succinct. Its purpose is to provide flexibility to a trustee when administering trust assets over the life of the trust.[33] Certainly the theory of the Prudent Investor Act is to provide clearer protection for a trustee than existed under prior law. The trustee who complies with the procedural guidelines of the Act, and documents that procedure, will not be judged in hindsight.[34] This emphasis on "procedural compliance" imposes a duty on the prudent trustee to establish written investment objectives and guidelines for investment decision making.

This requirement of "procedural compliance" becomes a two-edged sword. Strict observation will provide a substantial amount of protection for a trustee from disaffected beneficiaries. Conversely, failure to observe its formalities will leave a trustee exposed to serious damages if the trust portfolio suffers losses.

Most trustees being human, the author is skeptical that they will comply with *all* the procedural requirements of the UPIA, despite their best intentions. In consequence, a contentious administration will provide ample opportunity for second-guessing. Advance education certainly will assist the trustee in acting defensively, but occasionally even the best intentions go unfulfilled.

A trust portfolio that does not perform to the *beneficiary's* expectations may become fodder for a surcharge action. An argument will generally be available to such a beneficiary because it will be rare for a trust portfolio to have clearly outperformed the market. Since most portfolios do not perform perfectly, even when they perform well, a disgruntled beneficiary will generally have something to utilize in complaining about the trust administration.[35] In such circumstances the importance of procedural compliance becomes even more important.

A trustee must be wary of undue reliance on the settlor's instructions. For example, trust instruments typically contain language exonerating the trustee from liability for retaining assets within the trust on the day the trustee assumes fiduciary responsibilities. Notwithstanding such protection, a trustee who retains such assets for an extended period will do so at the trustee's peril if the assets do not prove to be a successful investment.[36]

In re Estate of Janes concerned a corporate fiduciary that was surcharged for imprudently retaining an asset. The corporate fiduciary had received a trust portfolio in the mid-1970's with Eastman Kodak comprising approximately 90% of the value of the trust estate. The surviving spouse was a co-trustee with a corporate fiduciary. At the time the corporate fiduciary assumed responsibility, Eastman Kodak was generally considered to be a "blue chip" investment. In the 1970's the corporate fiduciary, with the concurrence of the surviving spouse co-trustee, reduced the concentration of Eastman Kodak from 90% to approximately 70% of the value of the total portfolio. Subsequently, the corporate fiduciary retained the Eastman Kodak stock in this high concentration. The investment performance of Eastman Kodak from the late 1970's through the early 1990's was quite poor. In consequence, the value of the portfolio did not appreciate consistent with overall market indexes. Subsequent to the departure of the surviving spouse co-trustee, the remainder beneficiaries sought to have the corporate fiduciary surcharged for the loss in value of the portfolio.

The New York Surrogate's Court held the fiduciary liable for the amount the fiduciary would have earned had it liquidated the concentrated position and reinvested the proceeds. The Court determined the amount of damages by reference to the performance during the same period of one of the corporate fiduciary's own diversified equity funds, rather than by reference to compounded interest at the statutory rate.[37]

Generally, the longer a trust administration has progressed, the greater the risk in retaining assets. This problem is not academic. A common fact pattern has the family business constituting a significant portion of the trust estate. Typically, the younger generation lacks a key management skill to maintain the level of success achieved by the patriarch or matriarch. Usually, all of the members of the younger generation are not managing the business and therefore do not benefit in the same proportion as the operators. Invariably, these facts lead to a dispute between those who are "in" and those who are "out." In those circumstances the "in" group, which usually contains the trustee, will be on the defensive. The trustee may also have difficulty persuading the probate court that retention was indeed prudent.

Similarly, a trustee who diversifies, but who invests poorly, will undoubtedly face exposure from disgruntled beneficiaries. A challenge created by the extraordinary performance of the equities markets during the last decade is increased expectations by beneficiaries. The growth in unrealistic expectations that portfolios will continually increase imposes a dilemma on the trustee. Matching the market may not prevent disputes with greedy beneficiaries. Under-performing the market indices appears to be a guarantee of employment for litigation oriented attorneys. The UPIA serves as a useful opportunity for complaining beneficiaries to add yet another basis for breach of trust to their potpourri of allegations.

A trustee should therefore seek to limit his or her exposure by diligent reliance on the *investment policy statement (IPS)* contemplated by the UPIA. Setting performance criteria in the IPS will protect the trustee if those criteria are met, provided that the criteria are reasonable. Paradoxically, the author believes that setting performance criteria in the IPS will also protect the trustee, even if those criteria are *not* met. If the trust investment performance does not meet the IPS goals, the recovery available to the aggrieved beneficiaries will likely be limited to the difference between the actual performance and the IPS goals. In contrast, a failure to state any goals in the IPS, or the failure to have an IPS at all, will enable the aggrieved beneficiaries to claim a much larger amount, as was done in *Estate of Janes.*

II. LAWYER

A. INTRODUCTION

Attorneys who represent trustees face a gamut of ethical, malpractice, and practical issues. The tangled kitten's yarn of issues arises because trustees are a peculiar kind of client: they are fiduciaries, subject to a host of duties toward beneficiaries. In addition to fulfilling the professional duties that the attorney has to the trustee-client, the attorney also must be well versed in the duties that the trustee has to the beneficiaries in order to be able to advise the trustee-client.

Adding to the challenge of representing trustees is that the trustees are subject to the highest standard of conduct:

> "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 marketplace. Not honesty alone, but the punctilio of an honor 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 of fiduciaries been kept at a level higher than that trodden by the crowd." (Cardozo, J.) ***Meinhard v. Salmon*** 249 NY 458, 164 NE 545 (1928).

This high standard of behavior for the trustee-client may spill over to the attorney. This "spill-over" may create a duty to a non-client in addition to those to the trustee-client for the attorney.

Representing trustees differs from representing other fiduciaries, such as corporate directors or partners. Representing business parties usually allows the attorney to identify the client more efficiently. That is, the attorney usually represents the directors or the corporation or the shareholders (or the partnership, the general partner, or the limited partners). In trust administration, it is easier to blur the line between the parties because they are often related and because the same individual may hold several roles: trustee, beneficiary, shareholder or partner in a family business entity.

Also adding to the complexity of representing trustees is the fact that more than one person may occupy the role of trustee, either concurrently as co-trustees, or consecutively as successor trustees.

Issues facing the attorney representing the trustee-client include:

- Knowing the ethical and fiduciary duties of the attorney, such as the duties of loyalty (duty to avoid conflict of interest), confidentiality, competence, and communication;

- Providing full disclosure and obtaining proper informed consents regarding representation;

- Determining the existence of the attorney-client privilege and protecting it as necessary;

- Counseling the trustee-client regarding the trustee's duties and responsibilities;

- Practicing "preventively" to avoid trust litigation;

- Practicing defensively to avoid malpractice claims from both clients and non-clients; and

- Being paid.

B. Prophylactic
C. Coercive
D. Self-Defense
1. *Moeller* Issues
2. Malpractice Claims

Legal malpractice is a term difficult to define and its definition varies according to jurisdiction.[1] The prevailing view is that it encompasses professional misconduct broadly, including negligence and breach of fiduciary duty. ***Kelly v. Foster*** (1991) 62 Wash. App. 150 [813 P.2d 598], *review denied* 118 Wash.2d 1001 [822 P.2d 287] (legal malpractice includes breach of fiduciary duty).

One way to categorize legal malpractice cases is to differentiate between standard of care cases (*e.g.* mistakes, negligence) and standard of conduct cases (*e.g.* loyalty or confidentiality), also known as breach of fiduciary duty cases. The "standard of care" is the attorney's duty to exercise the knowledge, skill, and ability ordinarily possessed and exercised by other lawyers similarly situated and as such, the standard is constantly changing and evolving. A very common failing in the standard of care is the attorney's failure to develop the facts. In a trust administration, this duty often requires obtaining adequate information from the trustee-client. Receiving this information directly from the client can often reduce the possibility that the attorney "should have" known. As a suggested method of obtaining such information, a checklist/questionnaire for a trust administration is attached to this outline as Appendix F.

The "standard of conduct" cases are more serious than the "standard of care" cases. The "conduct" cases allege that the attorney committed a breach of fiduciary duty (*e.g.* loyalty, confidentiality, honesty), which implies greater moral blame, and often punitive damages are at stake. In the end there may not be substantive difference between the two kinds of cases since providing reasonable care is also a fiduciary duty.

[1] Mallen & Smith, Legal Malpractice (5th Ed. 2000) Section 1.1.

Attorneys representing trustee-clients have exposure to potential malpractice claims from at least two sources: their client-trustees and the beneficiaries who are not clients. The attorney representing trustee-clients may need to take affirmative steps to minimize this risk for liability to third parties who are not clients, at least in the attorney's view.

3. Relationship Between Ethical and Malpractice Issues

Ethical and malpractice concerns often overlap but are not identical. Violation of ethical duties provided under the local rules (*e.g.* California Rules of Professional Conduct) may result in disciplinary action by the State Bar. Malpractice or professional liability actions, on the other hand, are civil liability actions instituted by clients or third parties against the attorney.

Malpractice actions may allege breach of ethical duties as part of the cause of action; however, as with any other civil action, the breach itself is not sufficient. All the elements of the cause of action must be met for the plaintiff to prevail: the standard of care, duty, breach, proximate causation and damages. When a breach of ethical duties does not result in any actionable damages to the client, the client may nonetheless notify the state bar and the state bar may take disciplinary action. Clients may also take action to disqualify attorneys from representing other parties under the applicable ethical rules regarding conflict of interest rules.

Although ethical rules are not intended as basis of civil liability and thus the violation of the ethical rules do not create new causes of action, cases have held that the violation of these rules may constitute negligence. *See Charleson v. Hardesty* (1992) 108 Nev. 878; 839 P.2d 1303.

4. Common Situations: High Likelihood of Ethical Pitfalls and Practical Problems

Trust administration occurs because of the decedent's belief that there is a need to hold property in trust, for the benefit of the lifetime beneficiary and the remainder beneficiaries. This belief by a decedent donor is often not shared by the recipients of his largesse. This divergence in opinion often creates hostility by the donee against the (dead) donor. Since the donor is unavailable to hear the complaint of the beneficiary, however, the anger is usually displaced and redirected towards the fiduciary, and occasionally (derivatively) at the lawyer. Besides the purposes of probate avoidance and disability planning, both of which may serve everyone's benefit, a conflict of interest often exists, either potential or actual, among the trust beneficiaries. There may also be conflict among the co-trustees if they have different interpretations of the settlor's intent and the trust provisions, or different views regarding investment strategies and distributions. There also may be potential for conflict between the attorney and the trustee or between the trustee's attorney and the beneficiaries.

When confronting these potential conflicts, the attorney faces multiple challenges. One challenge is discharging the legal duty to clarify the identity of the attorney's client; i.e. the trustee. The second challenge is often practical: maintaining an effective administration without needlessly antagonizing either the (nonclient) beneficiary, or the (client) trustee.

Each of the following common situations presents the attorney with the challenge of appropriately addressing the ethical, malpractice and practical issues at hand:

Case A: A married couple is your joint estate-planning client. They are the settlors and original trustees of the revocable trust. One of them dies and the surviving spouse is the sole remaining trustee. The marriage was enduring and successful. All of the property was community, or some fashion of joint ownership. The survivor has no understanding of the consequences of the multiple subtrusts established by the instrument. The survivor considers all the trust property to be subject the exclusive dominion and control of the survivor.

Case B. A married couple was the joint estate planning client. Their marriage is the second for both. Upon the first death the survivor is the sole trustee. The decedent is survived by the surviving spouse, a child of the marriage, deceased client's children from a prior marriage, and the surviving spouse's children from a prior marriage. The deceased's children from a prior marriage and the child of the marriage are beneficiaries of the bypass and QTIP trust.

Case C: Your client dies and the surviving spouse is the successor trustee. Your client with substantial separate property is survived by the much younger surviving spouse and the client's children from a prior marriage, who are the remainder beneficiaries of the bypass trust and the QTIP trust.

Case D: The surviving spouse of your married clients has died and only one of the beneficiary children is named as the successor trustee. The settlors named the child they believed to be the most responsible (because that child is the favorite) of their three children to be the trustee. One of the other children has financial difficulties and the other has a rocky marriage. Alternatively, all three are doing well but there are long-standing family tensions. In any event, the appointment of one in preference to the others itself becomes a source of tension. This strain is usually compounded by a plan that requires the bypass and survivor's trust to continue for the lifetime of the children and then to be distributed to the grandchildren.

Potential issues to address in the common scenarios above include the following:

- Clarifying the scope of representation with the surviving spouse trustee or any other successor trustee;
- Counseling the surviving spouse client about whether to serve as trustee;
- Providing proper disclosures and obtaining informed consents (waivers), depending on other members of the family previously or currently represented;
- Providing appropriate disclosures and notice of non-representation to relevant parties (*e.g.* other beneficiaries);

- Counseling the individual trustee regarding trust administration: funding the subtrusts, investment duties, duty to account and report, etc.; and
- Assessing the potential for trust litigation: will and trust contests, property disputes or claims by and against the trust estate, actions against the trust or trustee, claims of beneficiaries' creditors, determination of heirs and beneficiaries.

Knowing what the law requires does not guarantee results: often, the challenge is in not knowing what the law is, but in the implementation. How do you obtain the required informed consent? How can you most effectively guide your trustee-client to comply with what the law requires? How can you minimize the risk of liability to third parties? How to achieve the desired outcome you desire?

5. Controlling Liability to the Beneficiaries

a) In General

The law regarding attorney liability to non-clients is expanding.[2] Reviewing the rules regarding potential liability in this area may also lead the attorney to decline a matter that one may ethically accept or lead an attorney to take appropriate defensive and affirmative steps to shield the attorney from potential liability. First are some practical rules; a more academic discussion follows.

b) Make Non-Engagement Clear

The attorney should inform the beneficiaries that the attorney is not representing them. Whenever an attorney represents a trustee, it is advisable to notify not only the trustee but also the beneficiaries that the attorney is representing only the trustee. Without such clarification, a beneficiary or even the trustee may believe that the attorney represents the "trust" and is thereby representing the beneficiaries.

In fact, the notification to the beneficiaries may be required if the beneficiaries have any reason to believe that the trustee's lawyer is somehow representing them or their interests because a lawyer has the duty to communicate to a person who reasonably believes they are clients that they are not clients. ***Butler v. State Bar*** (1986) 42 Cal. 3d 323, 329, 721 P.2d 585; ***Miller v. Metzinger*** (1979) 91 Cal. App. 3d 31, 154 Cal. Rptr. 22.

The attorney should also inform the beneficiary that the communications between the attorney and the beneficiary are not confidential or privileged and that the beneficiary should consider obtaining separate counsel in order to protect the beneficiary interest in the trust.

[2] See Professional Liability to Third Parties by Jay M. Feinman (ABA Tort and Insurance Practice Section and Section of Business Law 2000)[Comprehensive overview of this area of law from history to current law for lawyers and other professionals.]

The cautious attorney may choose to minimize and avoid direct communication with the beneficiaries, opting to have all communication come from the trustee. Practically speaking, that may be difficult. In the usual case, it may be prudent to document the facts supporting the absence of any attorney-client relationship between the attorney and the beneficiaries. ***Garner v. Wolfinbarger*** (5th Cir. 1970) 430 F.2d 1093, *cert. denied* 401 U.S. 974.

c) Avoid Engagement

In the course of trust administration the attorney should avoid taking any actions that will inadvertently raise the argument that the attorney is also representing one or more of the beneficiaries. ***Johnson v. Superior Court*** (1995) 38 Cal. App. 4th 463 [45 Cal. Rptr. 2d 312].

For example, a beneficiary may be the designated beneficiary of a pension plan or IRA and request assistance. The attorney should determine whether there are any conflict of interest issues and then proceed accordingly, be it to decline employment, to obtain the necessary informed written consents, or to proceed.

For an example of what NOT to do, see ***Morales v. Field, DeGoff, Huppert & MacGowan*** (1979) 99 Cal. App. 3d 307 [160 Cal. Rptr. 239], wherein the executor's attorney may have assumed duties to beneficiaries by sending them letters suggesting that the attorney will inform them of unusual developments and assuring them their interests will be protected in the estate proceeding.

6. Attorney Has Some Duty to Beneficiaries

The trustee's attorney does have some duties to the beneficiaries. The exact nature of the trustee's attorney duties to the beneficiaries is unclear. Since the attorney for the trustee is not the attorney for the beneficiaries, these duties are not the fiduciary duties of an attorney to a client. Accordingly, the lack of privity or contractual relationship between the attorney and beneficiaries means that the beneficiaries generally do not have an action for malpractice against the attorney. ***Goldberg v. Frye*** (1990) 217 Cal.App.3d 1258, 266 Cal. Rptr. 483.

While it seems possible to avoid an attorney-client relationship with the beneficiary through clear communication, it appears that the attorney of the trustee may have some duties to the beneficiaries, where such duties do not conflict with the attorney's fiduciary duties to the trustee. This conclusion stems from the fact that beneficiaries and other non-client third parties have been successful in holding attorneys liable in civil proceedings. The attorney may also have a duty to disclose to the beneficiaries any potential conflict of interest that the attorney may have affecting the beneficiaries' interest.

A minimum duty appears to be the duty of the attorney not to participate in the breach of fiduciary duty by the fiduciary. If an attorney participates in the breach of fiduciary duty by a fiduciary, the beneficiary may bring a legal action against the attorney. ***Wolf v. Mitchell, Silberberg & Knupp*** (1999) 76 Cal. App. 4th 1030 [90 Cal. Rptr. 2d 792]***; Pierce v. Lyman*** (1991) 1 Cal. App. 4th 1093 [3 Cal. Rptr. 2d 236].

The traditional "privity rule" that the attorney owes no duty to one with whom the attorney is not in privity is no longer the law in most jurisdictions. The laws in various jurisdictions differ. The courts in different jurisdictions have used different bases for expanding the third party liability of attorneys.

The original privity rule case in United States is ***National Savings Bank v. Ward*** (1879) 100 U.S. 195. California led the way in making exceptions to the privity rule with ***Biakanja v. Irving*** (1958) 320 P.2d 16. The California Supreme Court held a notary public liable for an invalidly executed will to a beneficiary, using a six-prong balancing text. ***Lucas v. Hamm*** (1961) 56 Cal. 2d 583 [364 P.2d 685] kept and modified the six-prong test, but provided a remedy under contract law consonant with the court's treatment of the plaintiff as the third party beneficiary. The California Supreme Court held the attorney liable to beneficiaries of a defective testamentary trust. ***Heyer v. Flaig*** (1969) 70 Cal. 2d 223 [74 Cal. Rptr. 225, 449 P. 2d 161] kept the six-prong balancing test, but discarded the "contract" element, making the cause of action one of negligence only. The California court refused to extend the third party liability in ***Goodman v. Kenney*** (1976) Cal. 3d 355 [134 Cal. Rptr. 375, 556 P. 2d 737] where the third party plaintiff sued an attorney who had negligently advised clients in an arm's length business transaction.

Some states, such as New York, have retained the privity rule for negligence actions, while accepting "near privity" for negligent representation actions. In states allowing negligence actions by third parties but only in limited exceptions, sometimes the negligent representation actions are an alternative theory available to third parties. ***Prudential Ins. Co. v. Dewey, Ballantine, Bushby, Palmer, & Wood*** (1992) 80 N.Y. 2d 377 [605 N.E. 2d 318, 690 N.Y.S.2d 831]. ***Home Budget Loans, Inc. v. Jacoby & Meyers Law Offices*** (1989) 207 Cal. App. 3d 1277 [255 Cal. Rptr. 483]; ***Riggs Nat'l Bank v. Freeman*** (S.D. Fla. 1988) 682 F. Sup. 519. Certain states such as Texas and Nebraska have retained the strict privity theory. ***Barcello v. Elliott*** (Tex 1996) 923 S.W.2d 575, 580; Lilyhorn v. Dier (Neb. 1983) 335 N.W.2d 554, 555. On the other end is Nevada and Kansas, where under the balancing test, the attorney may more likely be held liable to the beneficiaries. ***Charleson v. Hardesty*** (P.A. 1992) 108 Nev. 878 [839 P.2d 1303]; ***Pizel v. Zuspann*** (1990) 247 Kan. 54 [795 P.2d 42]. The most extreme at this end of the spectrum is Arkansas where the beneficiaries were determined to be joint clients with the executor. ***Estate of Torian v. Smith*** (Ark. 1978) 564 S.W.2d 521 (This case was a dispute over whether the executor's attorney could testify in support of a fee application. It may be that evidentiary disputes are distinguishable from malpractice liability issues.)

7. Theories of Recovery by Third Parties

The theories of recovery used by third parties have included third party beneficiary, negligence, negligent misrepresentation, fiduciary duty; and assumption of duty (or reliance or undertaking).

These theories are in additional sources of liability for attorneys, in additional to general gamut of causes of action under which attorneys may be sued, such as intentional tort claims, (*e.g.* fraud, malicious prosecution, abuse of process, defamation, and invasion of privacy) or statutory causes of action (RICO, security laws, *etc*.).

8. Third Party Beneficiary

The classic case is the disappointed beneficiary of a negligently prepared will. In most jurisdictions, an attorney may be liable for malpractice to an intended beneficiary. The general rule of liability makes sense given that the engagement is in large part for the purposes of making effective bequests. See ***Blair v. Ing*** (Hawaii 2001) 95 Haw. 247, 21 P.3d 452, for good overview of current state of law in this area.

a) Negligence (Tort)

This is the most common cause of action for cases outside negligence relating to wills. In elements of a cause of action for negligence are duty, breach of duty, causation, and damages. The basic issue in third party cases is whether a duty exists. The inquiry into the existence of duty can be done under different tests, such as the "balancing test" based on California law that many jurisdictions have also followed.

b) Negligent Misrepresentation (Near Privity)

Often overlapping with the theory of negligence, this theory is often used in cases where the third party relies detrimentally on some type of communication from the defendant attorney, such as in business transactions.

c) Fiduciary Duty, Assumption of Duty, Undertaking, Reliance

This cause of action relies on some specific act by the defendant attorney that results in the creation of a duty to the third party. The leading authority of these types of cases is found in New Jersey cases, beginning with *Stewart v. Sbarro* (1976) 142 N.J. Super. 581, 362 A.2d 581, certif. denied, 72 N.J. 459 [371 A.2d 63]. See also ***Petrillo v. Bachenberg*** (1995) 139 N.J. 472 [655 A.2d 1354] and ***Morales v. Field*** (1979) 99 Cal. App. 3d 307 [160 Cal. Rptr. 239].

9. California Case Law

Even after reviewing the apparently relevant cases, it is still difficult to formulate the rules and duties applicable to the attorney regarding their relationship with the beneficiaries. In California the ***Goldberg v. Frye*** rule providing that beneficiaries generally cannot bring a malpractice claim against the attorney of the administrator does provide some guidance. Nevertheless, definitive substantive guidance regarding the duties of the attorney to beneficiaries of a fiduciary estate is lacking. Outside California, jurisdictions vary significantly on whether be the beneficiaries of the estate (or legatees or ward of guardian) may bring a malpractice action against the attorney for the fiduciary (e.g. trustee, executor, or guardian)

a) Standing

- Successor personal representative have standing to sue attorneys of prior personal representative. ***Borissoff v. Taylor & Faust*** (2004) 33 Cal. 4th 523.

In **Borissoff**, the decedent died in 1989, leaving conflicting wills. By the time it was sorted out and Borrissoff was appointed the executor in 1995, much had happened. The special administrator Springer who had served interim had improperly "borrowed" money from the estate; Springer lost his attorney Taylor & Faust through withdrawal in February 1993 (probably due to Springer's failure to rectify breach of fiduciary duty); Springer himself had died in May 1993; and the estate's time to file an amended estate tax return had expired in September 1993.

In January 1997, Borissoff filed a petition to surcharge the Springer estate, without including a claim for the loss due to tax errors. He filed a malpractice action for the tax errors against Taylor & Faust in May 1998, relying on large part on ***Moeller v. Superior Court*** (1997) 16 Cal.4th 1125 [69 Cal.Rptr.2d 317] (holder of the attorney client privilege for confidential communications between trustee and attorney is the current trustee).

> The court affirmed the trial court, stating that reliance on ***Moeller*** is inappropriate and that the successor administrator had no standing to sue the attorney of the predecessor. It applied the six-prong test used in ***Goldberg v. Frye*** and also cited ***Estate of Lagios*** (1981) 118 Cal. App. 3d 459, 173 Cal. Rptr. 506, wherein surcharge against the attorney was found inappropriate.

The Supreme Court reversed the decision of the appellate court, reasoning that while an attorney hired by a fiduciary represents only that fiduciary, the legislature had created standing of successor fiduciaries to sue lawyers hired to perform tax services for the estate by a predecessor based upon the following statutes:

1. Probate Code section 8524, which provides that a successor personal representative has the powers and duties of the former personal representative;
2. Probate Code section 10801(b), which provides that the personal representative can employ or retain tax counsel and pay for such services from estate funds; and
3. Probate Code section 9820(a), which provides that a successor fiduciary has the power to commence and maintain actions and proceedings for the benefit of the estate.

The court also based its decision on *Moeller* (*supra*), in which the court held that a successor fiduciary, upon taking office, becomes the holder of the attorney-client privilege for certain confidential communications between the predecessor fiduciary and the attorney on matters of trust administration. The court reasoned that the decision in *Goldberg* did not apply because *Goldberg* held that an attorney for a fiduciary owes no duty to a beneficiary, rather than a successor fiduciary. From a practical perspective, the court added, if the successor fiduciary did not have standing to sue, then no one would be able to obtain the appropriate remedy for the damages arising from the attorney's negligence. Apparently the court did not agree with the defendants' argument that the successor fiduciary should be required to sue the predecessor, who would then be forced to bring an action against the attorney.

- Beneficiaries of an estate do not have standing to sue attorney of administrator. ***Goldberg v. Frye*** (1990) 217 Cal. App. 3d 1258 [266 Cal.Rptr. 483].

In ***Goldberg v. Frye,*** general legatees brought action against administrator of estate and attorney for administrator. The court granted summary judgment in favor of administrator and attorney, and appeal was taken. The Court of Appeal held that: (1) legatees were precluded from claiming that administrator engaged in malfeasance in separate action where they failed to raise such contentions at time of final accounting, and (2) legatees could not maintain a malpractice action against attorney of the administrator.

The court reasoned that

> "A key element of any action for professional malpractice is the establishment of a duty by the professional to the claimant. Absent duty, there can be no breach and no negligence. (citations omitted) By assuming a duty to the administrator of an estate, an attorney undertakes to perform services that may benefit legatees of the estate, but he has no contractual privity with the beneficiaries of the estate…
>
> Therefore, if the legatees are to have grounds for an action for malpractice against Frye, they must rely on circumstances and principles, from which a duty may arise absent privity of contract, and not based upon an attorney-client relationship.
>
> The principles governing such duty are set forth in 1 Mallen & Smith, Legal Malpractice (3d ed. 1989) section 7.11, page 382. The determination of duty rests upon the assessment of six considerations: "(1) the extent to which the transaction was intended to affect the plaintiff; (2) the foreseeability of harm to the plaintiff; (3) the degree of certainty that the plaintiff suffered injury; (4) the closeness of the connection between the defendant's conduct and the injury; (5) the policy of preventing future harm; and (6) whether recognition of liability under the circumstances would impose an undue burden on the profession."
>
> The predominant inquiry, Mallen states, is whether the principal purpose of the attorney's retention is to provide legal services for the benefit of the plaintiff. For example, the intention of a testator to benefit legatees, through the retention of an attorney to draft his will, can confer a cause of action in favor of a disappointed legatee against the negligent draftsman. (See, e.g., Lucas v. Hamm (1961) 56 Cal.2d 583 [15 Cal.Rptr. 821, 364 P.2d 685]; Biakanja v. Irving (1958) 49 Cal.2d 647 [320 P.2d 16, 65 A.L.R.2d 1358].)
>
> Viewing the legatees' claim in this light, we find it impossible to conclude that the parties to the attorney's contract…entered into same for the principal purpose of providing benefit to the legatees. We find nothing to indicate that this attorney's retention was in any respect different from the typical retention of counsel by the fiduciary of a decedent's estate. As noted above, such retention constitutes the counselor the attorney for the fiduciary, and not the attorney for the estate, its beneficiaries, its creditors or others who may be interested therein." *Id*. pp. 1267-1268

b) Attorney Liable If Participates In Trustee Breach

- If a third party knowingly participates in a breach of trust by the trustee, the trust beneficiaries may be able to bring a direct suit against the third party, without having to have the trustee sue on their behalf. ***Wolf v. Mitchell, Silberberg & Knupp*** (1999) 76 Cal. App. 4th 1030 [90 Cal. Rptr. 2d 792]; ***City of Atascadero v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*** (1998) 68 Cal. App. 4th 445 [80 Cal. Rptr. 2d 329].

In ***Wolf v. Mitchell, Silberberg & Knupp***, the mother's trust provided for the father, with the two sons Robert and Fred as the remaining beneficiaries. While father served as trustee, the father had commingled funds and Fred had inappropriately used the bulk of the trust estate with the cooperation of the attorney and accounting firm. The court stated:

> "In addition to the remedies for breach of trust specified in subdivision (a) of Probate Code section 16420 [Remedies for Breach of Trust], a beneficiary or cotrustee may "resort to any other appropriate remedy provided by statute or the common law." (Prob. Code, § 16420, subd. (b).) Such an appropriate common law remedy is defined in section 326 of the Restatement Second of Trusts. Section 326 of the Restatement provides that "[a] third person who, although not a transferee of trust property, has notice that the trustee is committing a breach of trust and participates therein is liable to the beneficiary for any loss caused by the breach of trust." (See also Bogert, Law of Trusts and Trustees (rev. 2d ed. 1995) § 868, pp. 104-109 [person who knowingly aids trustee in committing a breach of his duties is liable to the beneficiary]; 11 Witkin, Summary of Cal. Law (9th ed. 1990) Trusts, § 164, p. 1017 [beneficiary may sue third persons who participated in breaches of trust].) Comment a to section 326 of the Restatement Second of Trusts provides an example that is relevant to this case: "[I]f the trustee purchases through a stockbroker securities which it is a breach of trust for him to purchase and the broker knows [**19] that the purchase is in breach of trust, the broker is liable for participation in the breach of trust." (At p. 124.)
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> A Court of Appeal decision (decided after the lower court's decision in this case) expressly adopts the rule of Restatement Second of Trusts section 326. In *City of Atascadero v. Merrill Lynch, Pierce, Fenner & Smith*, Inc. (1998) 68 Cal. App. 4th 445 [80 Cal. Rptr. 2d 329] (Atascadero), the court considered whether beneficiaries of the Orange County Investment Pools, a statutory investment trust, could bring a direct tort action for breach of fiduciary duty (and other claims) against Merrill Lynch, a securities and financial broker and adviser, even though the county, the trustee of the investment pools, already had filed suit against Merrill Lynch. (Id. at pp. 451-458.) As in this case, the defendant in Atascadero argued that the suit only could be maintained by the trustee, and that the beneficiaries lacked standing. (Id. at pp. 458-459.) The Court of Appeal, drawing extensively on the authorities cited above, held that ". . . trust beneficiaries may bring suit on their direct claims against third persons who have actively participated with a trustee in a breach of trust for their own financial advantage, whether by inducing, aiding or abetting the trustee's breach of duty, or by receiving trust property from the trustee in knowing breach of trust." (Id. at p. 467; accord, Morales v. Field, DeGoff, Huppert & MacGowan (1979) 99 Cal. App. 3d 307, 314-315 [160 Cal. Rptr. 239] [beneficiary may sue attorney for trustee when attorney actively participates in a breach of trust].)" *Id.* pp. 1038-1039.

In ***City of Atascadero v. Merrill Lynch***, certain trust beneficiaries entered into a settlement agreement with the trustee, the County Treasurer of Orange County, that expressly permitted them to bring their own claims against Merrill Lynch. The trial court sustained Merrill Lynch's demurrer to the trust beneficiaries' second amended complaint without leave to amend. The main issue was whether the trustee rather than the beneficiaries had to bring suit against Merrill Lynch. Reversing the trial court, the Court of Appeal held that under certain circumstances, a trust beneficiary may sue third persons who directly participated with the trustee in breaches of trust, citing, ***Pierce v. Lyman*** (1991) 1 Cal. App. 4th 1093 [3 Cal. Rptr. 2d 236]; ***Saks v. Damon Raike & Co.*** (1992) 7 Cal. App. 4th 419, 428 [8 Cal. Rptr. 2d 869]; and Rest. 2d Trusts §§ 291-295, 326, pp. 57-73, 124-125.

In *Berg & Berg Enterprises, LLC v. Sherwood Enterprises* (2005) 131 Cal. App. 4th 802, appellants, an assignee for the benefit of creditors and the assignee's counsel, sought review of an order from the Superior Court of Santa Clara County, which granted leave to respondent creditor to file an amended complaint alleging a civil conspiracy between the assignee and its counsel. The court held that an action against an attorney based on actions performed with representation of a client in connection with any claim to contest or compromise a claim or dispute must comply with California Civil Code section 1714.10. That Civil Code section pertains to actions against an attorney for civil conspiracy with a client. In order to file such an action, a plaintiff must obtain an order from the court establishing a reasonable probability that the party will prevail in the action. The code section does not apply if (1) the attorney had an independent legal duty to the plaintiff, or (2) the attorney's acts go beyond the performance of a professional duty to serve the client and involve a conspiracy to violate a legal duty in furtherance of the attorney's financial gain. Cal. Civ. Code section 1714.10(c). The respondent creditor had argued that the requirements of Civil Code section 1714.10(c) applied to allow respondent to bring the action against attorney for the assignee.

The court held that the attorney did not owe an independent duty to respondent creditor. The court distinguished this case from *Wolf* because in *Wolf* the attorney had advised the beneficiary to waive an accounting, which act may have created an independent duty to the beneficiary. The attorney's misrepresentations to the beneficiary in *Wolf*, the court reasoned, veered into fraud and personal financial advantage on the part of the attorney, and accordingly, the action against the attorney in that case was permissible. In this case, no such misconduct was alleged by the creditor on the part of the attorney. *Id. at 828.*

The court in *Berg* also cites to an ABA Standing Committee on Ethics and Professional Responsibility, Counselling a Fiduciary, Formal Opinions 94-380. That opinion states "[w]hen the fiduciary is the lawyer's client all of the Model Rules prescribing a lawyer's duties to a client apply. … The fact that the fiduciary client has obligations toward the beneficiaries does not impose parallel obligations on the lawyer, or otherwise expand or supersede the lawyer's responsibilities under the Model Rules of Professional Conduct". The *Berg* court found this language to undercut "any suggestion provided in the comment to ABA Model Rules, rule 1.2 that an attorney representing a fiduciary may have "special obligations" to the beneficiary in the trust situation". *Berg & Berg* (2005) 131 Cal. App. 4th 802, footnote 12.

c) Assumption of Duty

"It is, of course, conceivable that the attorney for an administrator could undertake to perform legal services at the behest of, and as attorney for, a beneficiary of the estate. Under such assumed facts a duty would be created directly in favor of the beneficiary, an attorney-client relationship would be established, and the beneficiary would have recourse against the attorney for damages resulting from negligent representation. There is no evidence in this case (resorting to the documentation in support of and in opposition to the motions for summary judgment, as well as having recourse to the allegations of the first amended complaint), however, to support the establishment of an attorney-client relationship by virtue of direct contacts between Frye [attorney] and Goldberg [beneficiary], or any of the other legatees. Therefore, if the legatees are to have grounds for an action for malpractice against Frye, they must rely on circumstances and principles, from which a duty may arise absent privity of contract, and not based upon an attorney-client relationship." ***Goldberg v. Frye*** (1990) 217 Cal. App. 3d 1258, 1267-1268 [266 Cal.Rptr. 483].

Consider ***Morales v. Field, DeGoff, Huppert & MacGowan*** (1979) 99 Cal. App. 3d 307 [160 Cal. Rptr. 239] for its facts, though its general statements that "[a]n attorney who acts as counsel for a trustee provides advice and guidance as to how that trustee may and must act to fulfill his obligations to all beneficiaries. It follows that when an attorney undertakes a relationship as adviser to a trustee, he in reality also assumes a relationship with the beneficiary akin to that between trustee and beneficiary" is not good law:

> "[R]espondents [attorneys] sent appellant [beneficiary] a letter on October 9, 1969, which stated: "There is no action required to be taken on your part in connection with the hearing or further probate proceedings.' Respondents sent a second letter on October 15, 1969, which stated: '. . . we will keep you advised if anything unusual arises during the probate administration. Since all aspects of probate administration will be under court supervision and subject to court orders, you should feel reasonably assured that your interests will be protected." *Id.* pp. 311- 312.

> Other California cases have reaffirmed the general rule that an attorney for a trustee does not owe a duty to the trust beneficiaries. In *Berg & Berg Enterprises, LLC v. Sherwood Partners, Inc.* (2005) 131 Cal. App. 4th 802 [32 Cal. Rptr. 3d 325], the court describes the notion that the attorney for the trustee represents only the trustee a "firm proposition". See also *Sullivan v. Dorsa* (2005) 128 Cal. App. 4th 947, 964 ("An attorney engaged by a *trustee* does not thereby become the attorney for the trust's *beneficiaries*.")

d) Limitations on the Third Party Beneficiary Theory

The attorney has no duty to the beneficiary to an unsigned will. Testator was a cancer patient on chemotherapy and died before executing the will. The beneficiary claimed that the attorney had delayed and failed to follow-up though the attorney was aware that the testator was ill. Applying the Lucas v. Hamm six-prong balancing test, the court held that "imposition of liability in a case such as this could improperly compromise an attorney's primary duty of undivided loyalty to his or her client, the decedent." ***Radovich v. Locke-Paddon*** (1995) 35 Cal. App. 4th 946, 965 [41 Cal. Rptr. 2d. 573], citing ***Krawczyk v. Stingle*** (1988) 208 Conn. 239 [543 A.2d 733].

Nevertheless, a recent California case extended the rule in *Lucas* to allow a beneficiary under a will to bring an action against the attorney who drafted the will. The beneficiary alleged negligence on the part of the attorney because he failed to advised the testator that under California's care custodian laws, her gift to her intended beneficiary may fail unless she obtained a Certificate of Independent Review. *Orsonio v. Weingarten* (2004) 124 Cal. App. 4th 304.

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[21] Probate C. §16061
[22] See *Estate of DeLaveaga* (1958) 50 C.2d 480, *Coberly v. Superior Court* (1965) 131 Cal.App.2d 685)
[23] *Purdy v. Johnson*, 174 Cal. 521 [163 P. 893]
[24] *Purdy v. Johnson,* supra; *In re McCabe's Estate* (9148) 87 Cal.App.2d 430, 197 P.2d 35
[25] *In re McLaughlin's Estate* (1954) 268 P.2d 519 *subsequent* 43 Cal.2d 462, 274 P.2d 868
[26] *Rosenfield, Meyer & Susman v. Cohen* (1987) 191 Cal.App.3d 1035, 237 Cal.Rptr. 14
[27] Probate C. §16004(a).
[28] *Broffman v. Newman* (1989) 213 Cal.App.3d 252, 261 Cal.Rptr. 532
[29] *Van de Kamp v. Bank of America Nat. Trust & Sav. Ass'n* (1988) 204 Cal.App.3d 819, 251 Cal.Rptr. 530
[30] *Estate Of Clifford B. Pitzer* (1984) 155 Cal.App.3d 979, 202 Cal.Rptr. 855.
[31] *See e.g. Estate Of Howard* (1955) 133 Cal.App.2d 535, 284 P.2d 966 [guardian sold minor's jewelry to himself through another for below appraised value]
[32] Probate C. §§ 16002(a), 16003, 16045-16054.
[33] See Raskin, John D., "*Some Observations on Compliance with the California Prudent Investor Act*" 19 CEB Estate Planning and California Probate Reporter 32 (October '96); Hartog, John A. and Sanderson, Paul, "*A Trustee's Crime and Punishment: Managing Fiduciary Liability under the California Prudent Investor Act*", 4 California Trusts and Estates Quarterly 4 (Summer 1998); Hartog, John A. and Sanderson, Paul, "*Fiduciary Delegation of Investment Power under the California Uniform Prudent Investor Act*", 5 California Trusts and Estates Quarterly 4 (Spring 1999)
[34] Prob. C. § 16051
[35] *Noggle v. Bank of America* (1999) 70 Cal.App.4th 853, 82 Cal.Rptr.2d 829
[36] In re *Estate Of Janes*, 165 Misc.2d 743, 630 N.Y.S.2d 472 (Sur. 1995)
[37] In re *Estate Of Janes*, 165 Misc.2d 743, 630 N.Y.S.2d 472 (Sur. 1995)