JOHN H. LANGBEIN

14 TULIP TREE LANE
WOODBRIDGE, CT 06525
(203) 389-6564
FAX (203) 389-2608

YALE LAW SCHOOL
P.O. BOX 208215
NEW HAVEN, CT 06520-8215

COURIER DELIVERIES:
127 WALL STREET
NEW HAVEN, CT 06511

(203) 432-7299
FAX (203) 432-1109

September 5, 2000

William L. Gardner, Esq,
Morgan, Lewis & Bockius
1800 M. St., N.W.
Washington, D.C. 20036-5869

In re: Kamehameha Schools: Fiduciary Review of Trust Counsel

Dear Mr. Gardner:

I am replying to your letter of June 22, 2000, asking for my views, in my capacity as an expert on American trust practice and fiduciary administration, regarding the questions you propound there, and which I reproduce below.

> Question 1. "Who is the 'client' when legal advisors render professional services to KS [Kamehameha Schools]? For example, is the client KS, the trustees as a group, or the individual trustees?

A trust is a multiparty regime, comprising the settlor, whose intent governs the purposes of the trust; the beneficiaries, whose benefit the trust serves; and the trustee, who owns legal title in the trust property under the fiduciary duty to manage the property for the beneficiaries. See Restatement of Trusts (Second) § 3 (1959) (identifying these persons).

When, as in the present case, the settlor chooses to lodge the trusteeship with co-trustees, the trust regime also takes account of the duties and powers of the individual trustees in their relationships among themselves and in respect of the trust property.

A trust is not an entity in the sense of a corporation. A corporation is a juridical person, a trust is not. Trust is a relationship of obligation imposed upon the trustee for the benefit of the beneficiaries in accordance with the settlor's intent. See Restatement of Trusts (Second) § 2 (1959) (definition of trust).

There has been some confusion in the case law about the question of whether counsel engaged by the trustee represents the trustee or the beneficiaries. This issue arises mostly in cases involving the question of whether the trustee as client can plead attorney-client privilege in litigation brought by a beneficiary.

Particularly in Hawaii, the position is now clear that the lawyer's client is the trustee, not the beneficiary. Rule 42(a) of the Hawaii Probate Rules (1995), titled "Fiduciary as Attorney's Client," provides:

> An attorney employed by a fiduciary for ... a trust represents the fiduciary as client ... and shall have all the rights, privileges and obligations of the attorney client relationship with the fiduciary insofar as the fiduciary is acting in a fiduciary role for the benefit of one or more beneficiaries ....

Rule 42(b) then spells out the negative corollary: "An attorney for ... [a] trust does not have an attorney client relationship with the beneficiaries ...."

To be sure, a trustee functions under a strict duty of loyalty to administer the trust exclusively for the benefit of the beneficiaries. Restatement of Trusts (Second) § 170(1) (1959). That duty of loyalty pertains in all aspects of trust administration, including the trustee's decision to engage legal counsel. The trustee is not, however, a mere agent of the beneficiaries. The trustee is responsible for implementing the settlor's intention even when the settlor's intention conflicts with the desires of some or all of the beneficiaries. See, e.g., Restatement of Trusts (Second) § 337 (1959) (beneficiaries cannot compel termination of a trust if it would impair a material purpose of the settlor). The court defers to the discretion of the trustee in matters of fiduciary administration, notwithstanding beneficiary preferences. See Restatement of Trusts (Second) § 187 (1959) (court will not substitute its own judgment for that of the trustee except to remedy abuse of discretion). See generally, Louis H. Hamel, Jr., Trustee's Privileged Counsel: A Rebuttal, 21 ACTEC Notes 156 (1995) (explaining why these and other aspects of trust administration underscore the view that the trustee is the client, not the beneficiaries, when legal counsel is obtained on behalf of the trust).

It does not follow that because the trustee is the client, the trustee has unfettered power to plead attorney-client privilege against a beneficiary's demand for disclosure of attorney-client communications prepared for the trustee on behalf of the trust. Because the trustee acts under a duty to benefit the beneficiary (the duty of loyalty, Restatement of Trusts (Second) § 170(1) (1959)), which is afforced by the duties of disclosure to the beneficiary, there are circumstances in which it may be inappropriate for a trustee to plead its attorney-client privilege against the beneficiary. See Restatement of Trusts (Second) § 173, comment c (1959), which provides that "the beneficiary is always entitled to such information as is reasonably necessary to enable him to enforce his rights under the trust or to prevent or redress a breach of trust."

I turn now to the special problems that arise when the trust is administered by co-trustees.

The five KS Trustees serve under the terms of the trust created in the will of the settlor, Bernice Pauahi Bishop, of Oct. 13, 1883, as amended by two later codicils. Article 13 of the will devises the residue of her estate to the Trustees for the purpose of operating the schools. Article 14 sets the number of Trustees at five, provides for majority voting among them, and requires that a minimum of three Trustees "must join in all acts." Construing this language of the settlor's will, the Hawaii Supreme Court has said: "When a majority of the trustees act it is the act of all as 'a collective trustee.'" Richards v. Midkiff, 48 Haw. 32, 40, 396 P.2d 49, 55, citing Mossman v. Damon, 15 Haw. 401, 404 (Haw. Ter. 1904).

Hence, in matters of trust administration, including engaging legal counsel, the KS Trustees act collectively on behalf of the Trust. They must act with the requisite three-person majority, which is the Trust's coordination rule for overcoming the problem of dispersed authority that inheres in any system of multiple decisionmakers. Decisions made in accord with the Trust's three-person majority rule bind the Trust as though they were the decisions of the single trustee who administers a trust that has only one trustee. Even though a trust is not a juristic person or entity, co-trustees, "regardless of their number, are regarded in law as a single entity." In re Levy, 496 N.Y.S. 2d 911, 914 (N.Y. Sur. Ct. 1985).

None of the KS Trustees has authority to administer the Trust in his or her individual capacity, but only as part of a three-person or larger majority acting collectively on behalf of all the Trustees. When, therefore, the KS Trustees engage service providers, whether legal counsel or electricians or whatever, the majority Trustees bind all the KS Trustees, including any who opposed the decision. The majority Trustees engage counsel in their fiduciary capacity on behalf of the beneficiaries of the Trust.

Dissenting Trustees who believe that the majority Trustees are acting in breach of trust have the right and the duty to seek judicial relief. The Restatement says: "If there are several trustees, each is under a duty to the beneficiaries to participate in the administration of the trust and to use reasonable care to prevent a co-trustee from committing a breach of trust, and if necessary to compel a co-trustee to redress a breach of trust." Restatement of Trusts (Second) § 184 (1959). Accord, Richards v. Midkiff, supra, 48 Haw. at 42, 396 P.2d. at 56 (citing Restatement § 184).

I conclude, therefore, that when a legal advisor in engaged by the KS Trustees, that advisor renders professional services to the KS Trustees as a group, acting in their fiduciary capacity for the benefit of the charitable beneficiaries of the KS Trust. The KS Trustees are the client.

> Question 2. "In terms of legal services that may be charged to KS as an initial matter, how broadly are KS's interests defined? For example, when a trustee removal action is filed such as the one that the Attorney General filed in September 1998 to remove the former KS trustees, is it appropriate for the Trust to assume the cost of defending such a removal action as an initial matter?"

As part of its duty of prudent administration, a trustee operates under a duty to defend the trust against legal actions that the trustee prudently determines to be detrimental to the interests of the trust. Restatement of Trusts (Second) § 179 (1959).

This duty extends to the situation in which the trustee prudently defends against a removal action brought by a beneficiary or by someone standing in the shoes of the beneficiary. If the rule were otherwise, the beneficiaries would be able to remove the trustee at will, defeating the intention of the settlor who chose the trustee or who chose the process by which the trustee was appointed. Trustees have no business yielding to unjustified removal demands, and the courts have in general been hostile to trustee removal actions. "[T]he authorities are clear that a successful defense by a trustee against an effort to remove him as trustee is a defense on behalf of the trust estate." Saulsbury v. Denton Nat'l Bank, 25 Md. App. 669, 672, 335 A.2d 199, 201 (1975) (citing Bogert on Trusts).

However, removal is an essential remedy to protect a trust and its beneficiaries in cases of trustee incompetence or malfeasance. See Restatement of Trusts (Second) § 107, comment b, empowering the court to remove a trustee on grounds including "the commission of a serious breach of trust ...."

Of necessity, the trustee who defends a removal action operates in circumstances of embedded or structural conflict of interest. The conflict inheres in the trustee's proper performance of office. The trustee is under the duty to resist unmeritorious litigation, yet the trustee is self-interested in determining whether or not the questioned conduct is meritorious. This embedded conflict is not unique to trustee removal actions. Rather, it arises whenever the trustee defends against an action alleging breach of trust and demanding surcharge or other sanctions.

The governing rule must encourage the trustee to defend the trust and its rightful beneficiaries against unmeritorious claims. "When the trustee's administration of the assets is unjustifiably assailed it is a part of his duty to defend himself, for in so doing he is realizing the settlor's purpose." Saulsbury v. Denton Nat'l Bank, supra, 25 Md. App. at 674, 335 A.2d at 202. Sustaining a trustee who used trust funds to defeat a removal action, Justice Cardozo said: "He owed a duty to the estate to stand his ground against unjust attack. He resisted an attempt to wrest the administration of the trust from one selected by the testator and to place it in strange hands." Jessup v. Smith, 223 N.Y. 203, 207, 119 N.E. 403, 404 (1918), noted in 3 Austin W. Scott & William F. Fratcher, The Law of Trusts § 188.4, at 65-66 (4th ed. 1988) [hereafter cited as Scott & Fratcher]. Scott and Fratcher summarize the black letter law as follows: "Where the beneficiaries bring a proceeding for the removal of the trustee, the trustee can properly charge the estate with the expense of defending the proceeding." Id., § 188.4, at 65.

On the other hand, the law must be alert not to reward breach of trust by encouraging wrongdoer trustees to resist correction when beneficiaries complain. In the very nature of disputes of this sort, it is seldom clear at the outset which is which, whether the trustees are doing wrong or doing right. Depending on the issues, factual investigation and legal analysis are often required.

Trust law attempts to balance the two policies, that is, to deter trustee wrongdoing while encouraging trustee resistance to unmeritorious litigation. The starting point, consistent with the rule that trustees' actions are presumed lawful, see Restatement of Trusts (Second) § 187 (1959), discussed supra, is that steps taken to defend litigation are deemed appropriate applications of the trustee's duty to defend claims under Restatement of Trusts (Second) § 179 (1959). "[T]he question whether an action 'should be maintained in behalf of the estate apparently is one which calls for the exercise of discretion of the trustees.' The determination of the trustees not to bring suit [in a particular matter] ... is not subject to review in the absence of a showing of abuse of discretion." Richards v. Midkiff, supra, 48 Haw. at 56, 396 P.2d at 62 (quoting a New York case). See also Restatement of Trusts (Second) § 188, comment c (1959): "The trustee can properly incur expenses in employing attorneys ... so far as such employment is reasonably necessary in the administration of the trust."

The rule of deference to trustee decisionmaking in matters of trust administration places on any contestant the burden of showing that the trustee's conduct entailed abuse of discretion. Master Richards asserts a contrary position but cites no authority for it. Richards says "that it is the burden of the [former] Trustees under the circumstances that existed in this case to show that their expenditure of trust assets for attorneys' fees was appropriate ...." Report of Master Regarding Retention of Non-Staff Counsel, May 18, 2000, at 3 [hereafter cited as Richards Report]. The correct position (exemplified in the cited Restatement sections 179, 187, and 188, comment c) is that a trustee is presumed to act within the scope of his or her discretion when administering the trust, hence that the burden of demonstrating that the trustee has breached the trust (in this instance by hiring trust counsel) would be borne by the contestant.

When, however, in the outcome of such litigation the trustee is found to be at fault, the trustee will not be able to expense the legal fees to the trust. Extensive authority is collected in 3 Scott & Fratcher, § 188.4, at 68 n.11, and in the 1998 Supplement to that work, § 188.4, at 348-49 n.11. See, e.g., Jones v. Heritage Pullman Bank & Trust Co., 164 Ill. App. 3d 596, 518 N.E. 2d 178 (1987), holding that a trustee that breached its fiduciary duty to administer a trust in accordance with the terms of the trust was not entitled to recover attorney fees and litigation expenses from the trust. Accord, Estate of Cooper, 81 Wash. App. 79, 913 P.2d 393 (1996); Estate of McCart, 847 P.2d 184 (Colo. App. 1992). The application of this principle depends upon the procedural setting. Some precedents evidence the denial of an application for expenses when a trustee who has lost a breach of trust action thereafter seeks to charge the legal costs to the trusts. When the trust has already fronted the costs, the remedy in such circumstances is to have the trustee restore the sum distributed.

Returning to your question, whether it was appropriate for the KS Trust to assume the cost of defending the AG's removal action as an initial matter, the answer is that it is routine good practice for trustees to charge their trust with the initial expenses of defending against breach of trust litigation, including trustee removal litigation. However, in circumstances such as the case of the former KS Trustees, in which powerful evidence of wrongdoing emerged and led to the Trustees' resignation, the potential for recoupment of those expenditures in a surcharge action remains open. I recur to this point in answer to your Question 5, infra.

> Question 3. "When potential conflicts arise in the context of hiring counsel to defend against a trustee removal action, is it mandatory for the former trustees to seek instructions from the Probate Court under HRS § 554A-5(b) before such counsel is engaged?"

It will perhaps be helpful to identify the core principles that govern the procedural device of the trustee's petition for instructions in equity. I will indicate how your question would be resolved as a matter of the common law of trusts, and I will then examine the effect of HRS § 554A-5(b).

As codified in the Restatement, petitioning for instructions is a trustee's option. "The trustee is entitled to apply to the court for instructions as to the administration of the trust if there is reasonable doubt as to his duties or powers as trustee." Restatement of Trusts (Second) § 259 (1959); cf. id. at § 394 (replicating the principle of § 259 for charitable trusts). Accord, Bishop v. Pittman, 33 Haw. 647 (Haw. Ter. 1935).

Following abundant case law, the Restatement limits the trustee's power to seek instructions in the interest of judicial economy. It says: "The trustee is not entitled to instructions as to his powers or duties, unless there is a reasonable doubt as to the extent of his powers or duties." Restatement of Trusts (Second) § 259, comment b (1959).

Courts will not permit a trustee to employ the petition for instructions as a device to shift the work of trust administration to the court. "[W]here a matter rests within the discretion of the trustee, the court ordinarily will not instruct him how to exercise his discretion." Estate of Campbell, 38 Haw. 573, 582 (Haw. Ter. 1950). Accord, 4A Scott & Fratcher § 394, at 383 (citing, at n.6, Takabuki v. Ching, 695 P.2d 319 (Haw. 1985).

Because the determination of whether or not to defend a lawsuit is a trust administration issue within the trustee's discretion, a court would be reluctant to grant a petition for instructions on that question. The petition would raise the question at issue in the underlying lawsuit, but in advance of discovery and pretrial refinement, hence it would tend to replicate the underlying lawsuit in a disadvantageous posture. Such a petition would tend to multiply rather than to forestall litigation.

The fact that the trustee in such cases is conflicted does not alter the analysis. The trustee operates from a structural conflict of interest in deciding whether to defend a suit demanding trustee removal on grounds of breach of trust. Every trustee has such a conflict in every alleged case of breach of trust, for the reasons explained in my answer to Question 2, supra. If that sort of structural conflict were to incapacitate the trustee from obtaining legal counsel, no trustee could defend a breach of trust action, no matter how farfetched, without engaging in a wasteful, spinoff lawsuit seeking instructions about whether to defend. We do not in fact see such lawsuits, consistent with the rule that the court will not instruct a trustee on how to exercise administrative discretion.

HRS § 554A-5(b) does not alter the outcome. It provides:

> If the duty of the trustee and the trustee's individual interest ... conflict in the exercise of a trust power, the power may be exercised only by court authorization (except as provided in section 554A-3(c)(1), (5), (17) and (23)) upon petition of the trustee.

Master Richards cited this provision in his report of May 18, 2000, for the view that the former KS Trustees were obliged to obtain advance court approval before engaging counsel to defend themselves in the various proceedings from August 1998 onwards. Richards Report, at 9. But Richards overlooked the internal cross-references within HRS § 554A-5(b), which expressly exclude its application to various trustee powers codified in HRS § 554A-3(c), especially HRS § 554A-3(c)(23). Subsection 23, which is part of the Hawaiian enactment of the Uniform Trustee Powers Act, empowers the trustee "[t]o employ persons, including attorneys, ... to advise or assist the trustee ...." When read in conjunction with its internal cross-reference to HRS § 554A-3(c)(23), therefore, HRS § 554A-5(b) says that conflicted trustees have no duty to seek prior court approval before employing attorneys. (The specificity of this exclusion of attorney services in HRS § 554A-3(c)(23) would prevail over any counterargument based on HRS § 554A-3(c)(24), which authorizes the trustee to prosecute or defend actions, but does not speak to the employment of attorneys as in HRS § 554A-3(c)(23).)

The common law position is, therefore, undisturbed by the Hawaiian legislation. Trustees do not have any duty to petition for judicial instructions before defending breach of trust litigation, regardless of whether such litigation includes trustee removal among its remedial demands.

<u>Question 4</u>. "What duties, if any, were applicable to attorneys for KS to make disclosures to the beneficiaries or to the State Probate Court with respect to actions or inactions by the former trustees?"

This question raises issues that are the subject of a distinct specialty, the law and practice of legal-professional responsibility, on which you have engaged specialist expertise. As a matter of the national law and practice in my field of trust and fiduciary law and practice, I am not aware of trust-law-specific standards having been formulated in regard to this question.

In Hawaii, however, Probate Rule 42 does undertake to impose certain disclosure duties on trust counsel to trust beneficiaries and to the court. Rule 42(b) provides that even though the attorney for a "trust does not have an attorney-client relationship with the beneficiaries," the attorney "shall owe a duty to notify such beneficiaries ... of activities of the fiduciary actually known by the attorney to be illegal that threaten the security of the assets under administration or the interests of the beneficiaries." The official commentary to this provision says that the 1995 drafting committee "limited the notification requirement to illegal activities known by the attorney to be illegal that threaten the security of the assets or the interests of the beneficiaries. If the attorney does not in fact know the acts to be illegal, he cannot be faulted for failing to inform the beneficiaries." Hawaii Probate Rule 42(b), commentary.

The key term in Rule 42(b) is the word "illegal." Because of the scienter requirement, that is, the requirement that the attorney have actual knowledge that the trustee's conduct is illegal, Rule 42(b) would apply only to trustee conduct that was patently wrongful when broached to the attorney--for example, if the trustee were to seek counsel's guidance in looting the trust and laundering the stolen funds.

As applied to the conduct of the former KS Trustees, the question is whether any of the conduct for which it was sought to remove them exhibited this level of manifest impropriety. The question would raise an issue of fact, about what the former KS Trustees knew and intended, and about what the attorneys knew. Most of the troublesome Trustee conduct was not of the sort that would put an attorney on notice of probable illegality.

Consider, for example, the former Trustees' decision to take levels of compensation that were authorized by statute but that were, in my view, imprudent in amount. It is hard to characterize the taking of statutorily authorized compensation as being "illegal" in the sense of Rule 42(b). The Trustees' compensation was a matter of public record in the annual Trust accountings, hence it was quite visibly disclosed. I view the Trustees' insensitivity to prudence limits (and to the likely Internal Revenue Service opposition) regarding their compensation levels to be a breach of trust, but I would not equate their error of judgment in this regard with theft or other knowingly "illegal" conduct under Rule 42(b). A fortiori, under the precepts of the adversary system, it was appropriate for counsel to accept an engagement from the Trustees to assist the Trustees in advancing their view of a disputed matter before the courts.

I turn to Hawaii Probate Rule 42(c), which voices a reporting requirement to the probate court. This provision contemplates failure to engage in timely court-supervised estate administration and is not germane to the alleged breaches of trust committed by the former KS Trustees. Rule 42(c) deals with the need to achieve "efficient and effective management of the estate. The attorney has an obligation to monitor the status of the estate and to ensure that required actions <u>such as accountings and closing a probate estate</u> are performed timely." Rule 42(c) (emphasis supplied). It is in connection with this administrative work that Rule 42(c) imposes a duty on the attorney for the estate or trust "to bring to the attention of the court the nonfeasance of the fiduciary." Id. Because Rule 42(c) seems directed to the problem of neglect by a trustee (or other fiduciary) in preparing required judicial filings, Rule 42(c) provides slender support for the suggestion that it requires a trustee's attorney to sue his or her client or otherwise to report to the court arguable weaknesses in the trustee's position in fiduciary matters.

> <u>Question 5</u>. "What is KS's remedy if the Trust pays the cost of counsel for defending against a trustee removal action, but the former trustees are ultimately unsuccessful in defending against their removal?"

In order to respond to this question, one needs to be able to characterize the grounds on which trustee removal occurred or was threatened. The law does not always require the trustee to emerge victorious from litigation in order to be entitled to have the trust bear the expenses of trust litigation. "Even though the trustee is unsuccessful in the litigation, he is entitled to charge the estate with the necessary expenses, if he was not himself at fault in causing the litigation." 3 Scott & Fratcher § 188.4, at 63-64, citing authority, id. at 64. n.4.

Not every trustee removal action turns on culpable behavior. For example, a trustee who was removed on grounds of supervening incapacity might still be able to charge the trust for the legal costs arising from a good faith but ultimately unsuccessful effort to defend against the removal action.

By contrast, the removal proceedings against the former KS Trustees alleged severe breaches of the Trustees' fiduciary duties of loyalty and prudent administration. See Interim Trustees' Proposed Findings of Fact, Conclusions of Law and Order, Dec. 13, 1999; Interim Trustees' Trial Memorandum, Dec. 13, 1999.

Had the former KS Trustees been removed on these grounds, the Trust would have been entitled to refuse to pay for the Trustees' legal expenses in resisting removal. Further, the Trust would have had a claim to recoup from the Trustees any sums already expended by the Trust for such legal expenses. This is simply an application of the principle, discussed in my response to Question 2, supra, that "if the trustee was at fault in causing the litigation, he must personally bear the expenses of the litigation." 3 Scott & Fratcher, § 188.4, at 68 n.11 & 1998 Supp., 348-49 n.11. See also id. at 67 & n.8 & 1998 Supp., 348 n. 8, citing authority for the view that "where it is held that the trustee is subject to a surcharge, the [legal] expense is payable by the trustee personally." Compare Feinberg v. Adolph K. Feinberg Hotel Trust, 922 S.W.2d 21 (Mo. App. 1996), requiring a trustee who was surcharged for self-dealing to reimburse the trust for the legal costs.

Because the former KS Trustees resigned before being removed, the removal proceedings did not result in a removal decree. Were the current Trustees to bring an action against the former Trustees to recover the Trust's legal expenditures in defending the former Trustees in the removal proceedings, the current Trustees would bear the burden of proving that the former Trustees would have been removed. Extensive evidence and formal determinations regarding the alleged breaches of trust of the former Trustees resulted from the 1998-99 removal action and related proceedings, including the IRS closing agreement, various of the Masters' reports, and the judicial findings adduced in the interim removal proceedings. These materials would (if admissible) facilitate the current Trustees' discharge of that burden.

In bringing such litigation, the current Trustees would need to bear in mind that the prudence norm would apply to their decision to incur such litigation expenses, just as it does to any other aspect of trust administration. If the cost of bringing such litigation would be incommensurate with the likely recovery, either because of the difficulties of the litigation or the defendants' lack of means, it might be imprudent to undertake the case even though the prospects of winning it were sound. The Hawaiian Supreme Court has spoken to this point:

> Trustees are under a duty to the beneficiaries to take all reasonable steps to realize claims held in trust. However, they have no duty to bring an action to enforce a claim pertaining to the trust property if it appears unreasonable to do so either because the action might be unsuccessful or would involve an expense disproportionate to the possibility of success.

Richards v. Midkiff, 48. Haw at 52, 396 P.2d at 60 (citing Restatement of Trusts (Second) § 177, comment c (1959) (no duty to bring action foreseen to be unsuccessful or "uncollectible owing to the insolvency of the defendant").

> Questions 6 and 7. "What factors should be taken into account in determining whether to seek disgorgement of attorneys' fees under HRS § 560:7-205 with respect to certain legal advisors of KS?" "What standards should the current trustees of KS apply in determining whether to assert potential claims for disgorgement or damages against various professional advisors employed by the former trustees?"

I address these questions as one, in view of their overlap.

HRS § 560:7-205 is Hawaii's version of Uniform Probate Code (UPC) § 7-205, which was enacted with small variations that cross refer to other provisions of Hawaiian law. HRS § 560:7-205 provides that an interested party may petition the court to "review the propriety of [the trustee's] employment of any [service provider, including any attorney, as well as] ... the reasonableness of the compensation of any person so employed, and the reasonableness of the compensation determined by the trustee for his own services." The measure concludes: "Any person who has received excessive compensation from a trust may be ordered to make appropriate refunds." HRS § 560:7-205.

The official comment to UPC § 7-205 explains the rationale for this measure. Because the UPC departs from older probate procedure in allowing trustees to fix their own compensation and that of their agents without probate court approval, the drafters thought that "it seems wise to emphasize that any interested person can get judicial review of fees if he desires it." UPC § 2-705, comment, 8 Uniform Laws Annotated (part II) 498 (1997). See id. at 498-500 & 2000 Supp., at 39, for citations to case law applying the section.

The situation envisioned in HRS § 560:7-205 is that a trust overpays for trustee services or for legal services, then seeks a decree of restitution for the amount of the overpayment. HRS § 560:7-205 does not create a novel cause of action, rather it reminds the courts that the long-established doctrines of restitution law would be available to remedy mistaken payment in these probate and trust settings. The Restatement of Restitution § 21 (1937) provides: "A person who has paid money to another for ... services ... is entitled to restitution of an overpayment caused by a mistake as to the ... amount of services rendered ...." The leading treatise observes: "There is a seemingly endless variety of cases in which a person pays money not owed in the belief that he is obligated to do so, when in fact he is not. Restitution usually is granted almost as a matter of course ...." 3 George E. Palmer, The Law of Restitution § 14.8, at 174 (1978).

As applied to the legal services rendered to the KS Trust by law firms hired to defend the former KS Trustees in the removal litigation, the question is whether the various law firms rendered value at the time of performance commensurate with the payments. To hypothesize, a clear case for remedy under HRS § 560:7-205 would arise if it were shown that one of the law firms engaged by the former Trustees had padded its hours, hence that it charged for time not actually worked. In such a case the law firm would have received "excessive compensation from a trust," justifying as the remedy a decree "order[ing the law firm] to make appropriate refunds." HRS § 560:7-205.

That easy case of phantom billing is far removed from the present circumstances, in which the legal services being questioned were undoubtedly rendered. The former Trustees engaged several law firms to defend the former Trustees in what the former Trustees regarded as a misguided removal action, and to counsel and defend the former Trustees in related initiatives that the former Trustees explored in connection with the challenges to their administration of the Trust.

Master Richards faults the former Trustees for defending themselves at all. E.g., Richards Report, at 26, 31, 59-60, 72, 73. He also faults them for overdefending themselves, that is, for hiring more lawyers than he thinks they needed. Id. at 31, 49, 56. Whatever the merits of those contentions, they speak to the potential liability of the former Trustees to reimburse the Trust, as discussed in my response to Question 5, supra, and not to any suggestion that the law firms did not render the services for which they were engaged. Indeed, to some extent the grievance voiced in Master Richards' report is the opposite of that envisaged in HRS § 560:7-205. He is complaining that the lawyers did their work too well, effectively advancing the position of the former Trustees as client. In the adversary system, however, that is a virtue and not a vice. Apart from the duty not to engage in frivolous litigation, it is not the responsibility of a law firm to second-guess a client's decision about whether or how extensively the client chooses to take counsel or to defend litigation.

In that connection, HRS § 554A-7 (which is section 7 of the Uniform Trustee Powers Act) powerfully underscores the point that third-parties of all sorts, including service providers such as law firms, have no duty to question the powers or purposes of a trustee who engages the service provider. It says:

> With respect to a third person dealing with a trustee or assisting a trustee in the conduct of a transaction, the existence of trust powers and their proper exercise by the trustee may be assumed without inquiry. The third person is not bound to inquire whether the trustee has power to act or is properly exercising the power; and a third person, with-

out actual knowledge that the trustee is exceeding his powers or improperly exercising them, is fully protected in dealing with the trustee as if the trustee possessed and properly exercised the powers he purports to exercise.

As applied to law firm engagements, this unmistakable protection for third-party providers speaks directly to the position of the law firms that assisted the former Trustees in defending against breach of trust litigation, relieving the law firms of any responsibility for questioning the bona fides of the Trustees' representations regarding their purposes or their culpability.

Accordingly, it is exceptionally rare for a trustee or successor trustee or beneficiary to bring a disgorgement action against the law firm that represented a trustee. One case in which such an action was successfully brought, Crawford & Lewis v. Boatmen's Trust Co., 338 Ark. 679, 1 S.W.3d 417 (1999), entailed a finding that although the law firm had charged the trustee for services purportedly rendered to the trust, the law firm was in fact working for a beneficiary whose interests were adverse to the trust, and who was actively defrauding the trust. Unlike the situation of the trustee who is defending a challenge to his administration of a trust, the conflict of interest between the beneficiary and the trust in the Arkansas case was provoked by the law firm, which purported to represent the trust while in fact representing the adverse beneficiary.

The trustee who sued for disgorgement of fees in the circumstances evidenced in the Arkansas case was well within the principle of Restatement of Restitution § 21, discussed supra. The trustee in that case acted under a mistake in paying the law firm, because the law firm in fact was not performing services for the trust.

Disgorgement is a principle of restitution law that is applied in cases of unjust enrichment resulting from payment under mistake. The suggestion that disgorgement actions be brought against law firms who provided the former Trustees with precisely the advisory and litigation services that the former Trustees requested is flawed because it confuses cases in which services were rendered with the situation in which they were not.

<u>Question 8</u>. "What standards should the current trustees take into account in exercising their discretion as to whether to use in the future various professional advisors employed by the former trustees? For example, if it were determined that a professional advisor had failed to advise the former trustees of the potential implications of their actions or had otherwise acquiesced in such actions, may those facts be taken into account in determining whether such an advisor should continue to be used by KS?"

I have explained why, based on the evidence that I examined in connection with the removal proceeding and related matters concerning the former Trustees, I do not think it likely that there is any basis for a restitutionary claim against the law firms who counseled the former Trustees. I have also explained why I believe that potential liability for these legal costs may run from some or all of the former Trustees to the Trust in connection with surcharge-type proceedings. When trustees engage in conduct that breaches their fiduciary duties as trustees, they must be held to foresee that among the consequences of that conduct will be the legal expenses incident to correcting the breach.

Your Question 8 directs attention to the future relations of the KS Trustees with the law firms that advised the former Trustees.

The starting point, once again, is the principle of Restatement of Trusts (Second) § 187 (1959), that trust administration lies within the good faith discretion of the trustee. The decision to hire legal advisors falls squarely within this familiar principle. Trustees have broad discretion, subject to their overriding duty of prudence in administration, to decide whether to continue using legal advisors who served their predecessor trustees.

Retaining former legal advisors normally obtains for a trust the advantage of economy, in that the former advisors are already familiar with the details of the client's affairs. Trustees operate under a duty of sensitivity to cost minimization, and continuity in legal representation would often serve that end. See Restatement of Trusts (Second) § 188 (1959); Restatement of Trusts (Third) § 227(c)(3) (1992); Uniform Prudent Investor Act § 7 (1994), enacted in Hawaii as HRS § 554C-7.

Here as elsewhere, however, it is possible to be penny wise and pound foolish. The savings associated with continuity are but one factor that prudent trustees bear in mind when deciding whether to retain legal advisors. The trustees of a major eleemosynary institution such as the KS need legal advisors with vision, probity, and candor. If the current Trustees come to the view that any of the legal advisors to the former Trustees behaved cravenly, that the advisors were too compliant in assisting the predecessor Trustees with questionable transactions, that view of the matter would call into question the quality of the legal advice that had been rendered, and it might well incline the current Trustees to place future legal business elsewhere.

Respectfully submitted,

John H. Langbein

JHL/st