

Endangering Individual Autonomy in Choice of Lawyers and Trustees—Misconceived Conflict of Interest Claims in the Kamehameha Schools Bishop Estate Litigation

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INTRODUCTION

This Article discusses two claims of conflict of interest made in legal actions involving the Kamehameha Schools Bishop Estate Trust ("KSBE" or the "Trust") during the period of November 1998 to March 1999. The first

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The author was retained as a consultant and expert witness in several of the legal proceedings involving Kamehameha Schools Bishop Estate during the period of November 1998 to March 1999. The author's expertise relevant to these legal actions was in the law governing the professional responsibility of attorneys and the law of conflicts of interest. All of the opinions expressed in this Article are the author's own and do not represent the opinions of Kamehameha Schools Bishop Estate or any members past or present of its Board of Trustees. All of the observations and opinions expressed in this Article are based solely on information from documents on file and available to the public in the Kamehameha Schools Bishop Estate actions, public newspaper accounts of those proceedings, and published case reports and statutes available in any law library.

claim of conflict of interest attacked the attorney-client relationship between KSBE and its attorney. The second conflict claim sought to sever the relationship between KSBE and its Board of Trustees (the "Board"). Both conflict claims were sustained by rulings of the probate court of Hawai'i. If given even informal value as a precedent by other trial courts, these rulings will be a significant step toward the elimination of a valuable freedom enjoyed by individuals under Anglo-American law. The endangered freedom is the right of any person to choose a fiduciary to accomplish a sophisticated or complicated task beyond the ability of the individual to undertake successfully.

The probate court rulings discussed in this Article have the perverse capacity to disrupt the effective operation of countless fiduciary roles, including that of an executor of an estate as well as that of an attorney retained by a client.¹ The large potential for ill effect stems from the conflict of interest concepts embraced in the rulings.² One method for correcting the errors in these rulings is by debating the validity of the rulings in scholarly journals, and this Article was written to initiate such a debate.

¹ Although the academic literature does not stress the point, an attorney has a fiduciary relationship with the attorney's client in the same way an agent has a fiduciary relationship with the principal or a trustee has a fiduciary relationship with the beneficiaries. See CHARLES W. WOLFRAM, MODERN LEGAL ETHICS § 4.1 (1986). Because the attorney-client relationship is heavily regulated by codes of legal ethics, attorney conflicts problems are usually regarded as outside the application of the law of fiduciary obligations or trusts. Nonetheless, both fiduciary relationships are governed by the same general conflict of interest principles. These principles lead to the same results in similar conflict of interest issues regardless of whether the fiduciary is an attorney in the attorney-client relationship or the fiduciary is a trustee in the trustee-beneficiary relationship.

The trustee-beneficiary relationship is more complicated than the attorney-client relationship. The client initiates the relationship in the latter, and it is the client's intentions and wishes that direct the duties of the attorney. In the trustee-beneficiary relationship, the settlor initiates the fiduciary relationship, and it is the settlor's original intentions, on rare occasions modified by the trustee's good faith determination of the best interests of the beneficiary, that direct the trustee. Nonetheless, the beneficiary of the trustee's performance of fiduciary duties is considered to be the beneficiary of the trust. See 1 AUSTIN W. SCOTT & WILLIAM F. FRATCHER, THE LAW OF TRUSTS, § 2.5 (4th ed. 1987); RESTATEMENT (SECOND) OF TRUSTS § 2 cmt. b (1959).

² The guiding concept in fiduciary conflicts questions is the same, whether the relationship is between an attorney and a client or a trustee and a beneficiary. That concept is whether the individual financial or personal concerns of the fiduciary will impair his or her ability to carry out the intentions of the person establishing the fiduciary relationship. Thus, the most important consideration in determining conflict issues is accomplishing the intentions of the client in an attorney-client relationship, or the intentions of the settlor in a trustee-beneficiary relationship. The trial court rulings on the conflict claims in the KSBE actions disregarded this lodestar concept in the law of fiduciary relationships. See discussion *infra* Parts II and III.

It is important to debate the wisdom of the conflicts of interest principles embraced in the rulings because voluntarily established fiduciary relationships are extremely valuable to individuals and society at large. Fiduciary relationships enable individuals to act more effectively than they could without the benefit of the sophistication and continuity of action provided by a fiduciary. In a society founded on principles of limited government, economic free enterprise, and individual liberty, increasing the effectiveness of individuals to accomplish lawful objectives is an objective of the highest priority.

Court action preventing an attorney or a trustee from fulfilling a fiduciary obligation frequently has serious consequences for individuals benefiting from the performance of the fiduciary obligation. Cumulatively, court actions of this type erode the principle that individual freedom of action is of the greatest value to our society. For these reasons, development of erroneous conflict of interest concepts that prevent fiduciaries from fulfilling their obligations, and court orders accepting such concepts, is a matter of great concern.

Anticipating the discussion to follow, the author believes that the rulings eliminating the attorney-client privilege and the limited removal of the KSBE trustees from participating in the investigation of the Trust by the Internal Revenue Service ("IRS") stemmed from a failure to give proper importance to the expressed intentions of the person establishing the fiduciary relationships, Princess Bernice Pauahi Bishop ("Princess Bishop"). In conflict of interest controversies, the Anglo-American legal tradition considers the desires of the person establishing the fiduciary relationship to be the most important consideration.³ Unless rectified on appeal, the much publicized trial court rulings in the KSBE actions⁴ may foster conflict of interest rulings that will defeat the intentions of individuals seeking to establish fiduciary relationships and play havoc with attorney-client and trustee-beneficiary relationships for years to come.

Part I of this Article sets out the factual and litigation contexts in which the conflict claims were made. Part II evaluates the first conflict claim, which related to attorney-client privilege. The second conflict claim, which challenged the propriety of trustee supervision of KSBE's response to ostensibly serious allegations of tax law violations, is evaluated in Part III. On policy and legal grounds, Parts II and III conclude that the probate court rulings accepting the conflict claims under examination were in error.

³ See GEORGE G. BOGERT & GEORGE T. BOGERT, *THE LAW OF TRUSTS AND TRUSTEES* § 481 (2d rev. ed. 1978).

⁴ See, e.g., Rick Daysog, *Bishop Estate Master Seeks Panel to Take over Trustees' Tax Work*, HONOLULU STAR-BULLETIN, Jan. 22, 1999, at A-3 [hereinafter Daysog, *Tax Work*]; Rick Daysog, *Judge Removes All 5 Trustees from IRS Case, Will Pick Panel*, HONOLULU STAR-BULLETIN, Feb. 4, 1999, at A-1; Rick Daysog, *State Hails a 'Wake-up Call'; Estate Says Ruling is 'Bizarre'*, HONOLULU STAR-BULLETIN, Feb. 5, 1999, at A-1.

I. THE CONTEXT AND CONTENT OF THE CONFLICT CLAIMS

A. The KSBE Actions

In broad terms, the KSBE actions included a number of law suits, investigations, and legal proceedings challenging the decisions and the conduct of members of the Board over a period of years.⁵ KSBE is a testamentary trust established by the will of Princess Bishop executed shortly before her death in 1884. The initial assets of KSBE were the extensive Hawaiian lands owned by Princess Pauahi Bishop. She had inherited these lands as the last living descendent of King Kamehameha. The will devised her property to five named trustees to be held subject to a trust to erect and maintain a school for Hawaiian boys and girls, to be "called the Kamehameha Schools."⁶

The will provided that future vacancies on the KSBE Board should be filled by "the choice of a majority of the Justices of the [Hawai'i] Supreme Court"⁷ Anticipating future divisions of opinion among the five-member Board, the will stated: "I direct that a majority of my said trustees may act in all cases and may convey real estate and perform all of the duties and powers hereby conferred; but three of them at must join in all acts."⁸ At the present, the value of the trust's assets is estimated to be about six billion dollars.⁹

Various legal actions and court and administrative proceedings involving KSBE and members of the Board have been filed in recent years. The conflict claims discussed in this Article were raised in two of the KSBE legal actions. Among the other actions and proceedings involving KSBE, the most heavily reported was an investigation by the acting Attorney General of the State of Hawai'i into the management and supervision by the Board of KSBE's extensive property and business interests.¹⁰ That investigation officially

⁵ Only those events and proceedings in the KSBE actions which bear directly upon the two conflict claims will be mentioned in this summary. The events and proceedings in the KSBE actions were so numerous and multifaceted that a summary of all of the events and proceedings in this Article would be impractical.

⁶ *Will of Bernice Pauahi Bishop* art. 13 [hereinafter *Will*]. The Will is reprinted in Appendix B of this issue of the *University of Hawai'i Law Review*.

⁷ *Id.* art. 14.

⁸ *Id.*

⁹ See Rick Daysog, *9 of 10 Residents Back Bishop Ouster*, HONOLULU STAR-BULLETIN, May 24, 1999, at A-1.

¹⁰ See Mike Yuen, *Trustees Face State Inquiry*, HONOLULU STAR-BULLETIN, Aug. 13, 1997, at A-1; Jim Witty, *Bronster Says That If Serious Misconduct Is Revealed, Trustees Could Be Removed*, HONOLULU STAR-BULLETIN, Sept. 11, 1997, at A-1. In April 1999, the Hawai'i Senate did not re-appoint Margery Bronster to a second term as the Hawai'i State Attorney General.

commenced in 1997¹¹ and produced indictments of two Board members.¹² Both indictments were quashed by the probate court shortly after the indictments were handed down.¹³

The first of the two proceedings in which significant conflict claims were made was a lawsuit filed by two members of the Board, Gerard Jervis and Oswald Stender, to remove from office a third member of the Board, Lokelani Lindsey.¹⁴ This "trustee removal action" was filed in December 1997. After trial, the probate court judge issued an order in May 1999 removing trustee Lindsey.¹⁵ That order is presently under appeal.¹⁶

The second proceeding, the "limited Board removal action," was filed after the IRS began an audit of KSBE¹⁷ that focused on possible violations of federal tax laws.¹⁸ This second proceeding was initiated by the same two

See Craig Gima, 'A Deal Was Cut', HONOLULU STAR-BULLETIN, Apr. 29, 1999, at A-1. However, the attorney general's investigation has continued under her successor, Earl Anzai. See Anzai Cleared to Handle Bishop Estate Matters, HONOLULU ADVERTISER, July 20, 1999, at A-1.

¹¹ See Yuen, *supra* note 10; Witty, *supra* note 10.

¹² See Rick Daysog, *Grand Jury Indicts Peters in Theft*, HONOLULU STAR-BULLETIN, Nov. 26, 1998, at A-1; Rick Daysog, *Wong Says He'll Win in Courtroom*, HONOLULU STAR-BULLETIN, Apr. 13, 1999, at A-1.

¹³ See Walter Wright, *Judge Throws out Wong Indictments*, HONOLULU ADVERTISER, June 17, 1999, at A-1; Rick Daysog, *State Lets Bishop Trustee Wong and Wife off the Hook for Now*, HONOLULU STAR-BULLETIN, June 30, 1999, at A-3; Rick Daysog, *Judge: Peters Didn't Get a Fair Hearing*, HONOLULU STAR-BULLETIN, July 2, 1999, at A-1. Peters was indicted again on August 4, 1999. See Rick Daysog, *Peters, Stone Indicted Again by Grand Jury*, HONOLULU STAR-BULLETIN, Aug. 5, 1999, at A-8. That indictment was also dismissed. See Ken Kobayashi, *Peters' Case Dismissed*, HONOLULU ADVERTISER, Dec. 18, 1999, at A1.

¹⁴ See Petition for Removal of Trustee Marion Mae Lokelani Lindsey, In re *Estate of Bishop*, Equity No. 2048 (Haw. Prob. Ct. Dec. 29, 1997).

¹⁵ See Order Granting Petition for Removal of Trustee Marion Mae Lokelani Lindsey Filed on December 29, 1997, In re *Estate of Bishop*, Equity No. 2048 (Haw. Prob. Ct. May 6, 1999) [hereinafter *Lindsey Removal Order*].

¹⁶ See Rick Daysog, *Ex-Trustee Lindsey Faces More Problems with IRS*, HONOLULU STAR-BULLETIN, Oct. 12, 1999, at A-8. Although Lindsey has since resigned as trustee, she is continuing to appeal the removal order. See *Attorney General Asks Court to Toss out Appeal of May Removal Order*, HONOLULU STAR-BULLETIN, Dec. 22, 1999, at A-2.

¹⁷ See Pete Pichaske, *IRS Audit Can Be 'Ruinous' to Tax-Exempt Organizations: Bishop Estate and the IRS Have Confirmed an Audit of the Trust*, HONOLULU STAR-BULLETIN, Nov. 4, 1997, at A-1.

¹⁸ See Rick Daysog, *IRS Audit Puts Added Pressure on Estate*, HONOLULU STAR-BULLETIN, Sept. 17, 1998, at A-1. KSBE and the IRS have entered into a settlement agreement, which has been approved by the court, that provides for payment to the IRS of nine million dollars by KSBE to secure its tax-exempt status. See Order Approving Petition for Approval of Settlement of IRS Audit Issues, In re *Estate of Bishop*, Equity No. 2048 (Haw. Prob. Ct. Dec. 1, 1999) [hereinafter *Order Approving IRS Settlement*]; Ken Kobayashi, *Settlement OK'd for Estate, IRS*, HONOLULU ADVERTISER, Dec. 2, 1999, at A1.

Board members who had brought the trustee removal action.¹⁹ The two trustees, who disagreed on a number of public issues with the majority of the Board, petitioned the probate court for an order removing the entire Board from participating in the negotiation of the deficiency claims with the IRS.²⁰ This limited Board removal action was initiated by a petition filed in January 1999.²¹

The probate court granted the petition shortly after it was filed, ordering all members of the Board to abstain from any participation in the negotiations and appointing a new Board for the limited purpose of supervising KSBE's response to the IRS claims.²² In May 1999, the probate court removed the old Board from their offices until the claims of the IRS were resolved.²³ The removal order was originally appealed by members of the old Board, but that appeal was subsequently abandoned.²⁴

B. The Conflict Claims

1. The privilege elimination claim

The conflict claims in the KSBE actions were imaginative if ill-founded. The first conflict claim was raised in the trustee removal action. The conflict claim stated that the filing of a removal action between trustees created a

¹⁹ See Trustees Oswald Kofoad Stender and Gerard Aulama Jarvis' Petition for Approval of Voluntary Recusal with Respect to Pending Tax Audit and for Appointment of a Panel of Special Administrators with Respect to Pending Tax Audit, In re *Estate of Bishop*, Equity No. 2048 (Haw. Prob. Ct. Jan. 29, 1999) [hereinafter Petition for Recusal].

²⁰ Before the proceeding was filed, the Special Master appointed to review the yearly accounting of KSBE had formally recommended that the Board be removed from participation in negotiations and supervision of KSBE's response to the IRS tax deficiency claims. See Daysog, *Tax Work*, *supra* note 4.

²¹ See Petition for Recusal, *supra* note 19.

²² See Minute Order Regarding Trustees Oswald Stender and Gerard Jarvis' Petition for Approval of Voluntary Recusal with Respect to Pending Tax Audit and for Appointment of a Panel of Special Administrators with Respect to Pending Tax Audit and Trustees' Petition for Instructions and Approval of Appointment of IRS Dispute Advisory Panel, In re *Estate of Bishop*, Equity No. 2048 (Haw. Prob. Ct. Feb. 4, 1999) [hereinafter Minute Order].

²³ See Order Regarding Order to Show Cause Regarding Special Purpose Trustees' Report and Order to Show Cause Regarding New CEO Based Management System, In re *Estate of Bishop*, Equity No. 2048 (Haw. Prob. Ct. May 7, 1999), available at <<http://starbulletin.com/1999/05/07/news/removal.html>> [hereinafter Removal Order].

²⁴ See *Then There Were None: Kamehameha Supporters Embrace the Chance for Reform and Healing*, HONOLULU STAR-BULLETIN, May 8, 1999, at A-1. A proposed settlement of the tax liability of KSBE and its tax-exempt status of KSBE was reported in August 1999. See Rick Daysog, *Proposed Estate Deal: Pay IRS \$9 Million-Plus*, HONOLULU STAR-BULLETIN, Aug. 23, 1999, at A-1. The probate court approved the settlement in December 1999. See Order Approving IRS Settlement, *supra* note 18.

dispute between former clients of the "Board attorney,"²⁵ who advised and otherwise represented the Board.²⁶ The effect of this alleged conflict was to eliminate the attorney-client privilege between the Board attorney and his former clients.

The existence of a dispute between an attorney's former clients eliminates the attorney-client privilege covering communications between the clients and their former attorney that are relevant to the clients' present dispute.²⁷ Thus, this "privilege elimination" claim had a superficial appearance of validity. In the specific terms of the trustee removal action, the plaintiff minority trustees claimed the right to discover and introduce into evidence confidential communications regarding KSBE matters between the Board attorney and Board members that were relevant to the trustee removal action.²⁸

One of the most important duties of all fiduciaries, including attorneys, is to keep confidential all private communications engaged in with the entity to whom fiduciary duties are owed regarding matters within the relationship.²⁹ Confidentiality is considered so important to the attorney-client fiduciary relationship that the law of evidence deems such communications privileged and beyond court-compelled disclosure regardless of the relevance and probative value of the communications.³⁰ The Board attorney, as a fiduciary

²⁵ For the sake of simplicity, the singular term "Board attorney" will be used to refer collectively to the many attorneys in the office of the general counsel of KSBE and in the independent law firms who acted under the direction of the KSBE general counsel to represent the Trust in the various transactions and lawsuits to which the Trust was a party.

²⁶ See, e.g., Petitioner-Defendant Oswald Kofoad Stender's Motion to Compel Respondent-Plaintiff Marion Mae Lokelani Lindsey to Produce Documents and to Appear for Her Deposition, In re *Estate of Bishop*, Equity No. 2048, at 8 (Haw. Prob. Ct. May 12, 1998) [hereinafter Stender's Motion to Compel]; Petitioner-Defendant Oswald Kofoad Stender's Reply Memorandum to Respondent-Petitioner Marion Mae Lokelani Lindsey's Memorandum in Opposition to Petitioner-Defendant Oswald Kofoad Stender's Motion to Compel Respondent-Plaintiff Marion Mae Lokelani Lindsey to Produce Documents and to Appear for Her Deposition, In re *Estate of Bishop*, Equity No. 2048, at 5-6 (Haw. Prob. Ct. May 26, 1998) [hereinafter Stender's Reply].

²⁷ Proposed Federal Rule of Evidence ("FRE") 503(d)(5) states the universally accepted "dispute between former clients" exception to the attorney-client privilege. The Hawai'i Rules of Evidence incorporate the exception: "[T]here is no privilege under Rule 503 of the Hawai'i Rules of Evidence as] to a communication relevant to a matter of common interest between two or more clients if the communication was made by any of them to a lawyer retained or consulted in common, when offered in an action between any of the clients" HAW. R. EVID. § 503(d)(6).

²⁸ See, e.g., Stender's Motion to Compel, *supra* note 26, at 8; Stender's Reply, *supra* note 26, at 5-6.

²⁹ See MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.6 (1995).

³⁰ See HAW. R. EVID. § 503(b) (stating attorney-client privilege).

of KSBE, owed the duty of confidentiality to the Board, which consisted of the fiduciaries of the Trust.³¹

The privilege elimination claim was premised upon the assertion that the Board attorney had a conflict of interest because he had an individual attorney-client relationship with each Board member.³² Thus, according to the claim, the Board attorney was representing both the individual plaintiff trustees (i.e., trustees Jervis and Stender) and the individual defendant trustee (i.e., trustee Lindsey) when those trustees were functioning as Board members and there was no dispute between them.³³ Arguing from the concept of Board attorney representation of each individual trustee, the privilege elimination claim pointed out that the trustees, who formerly were in agreement, were now in dispute, thus triggering the exception to the attorney-client privilege regarding disputes between former clients.³⁴

The probate court accepted the conceptual premise of the claim and held that the exception eliminated the attorney-client privilege because the dispute between the plaintiff and defendant trustees in effect created a conflict of interest for the Board attorney.³⁵ As noted, the trustee removal action has ended with the court removing the defendant trustee.³⁶ The propriety of the court's order to the Board attorney to disclose confidential communications may be tested through an appeal from the judgment removing the defendant trustee.

2. *The limited Board removal claim*

The second conflict claim was raised in the limited Board removal action. There, two minority members of the Board asserted that the IRS's claims against KSBE for tax deficiencies, which necessarily challenged the Board's past judgment on federal income tax law, created a conflict of interest between the entire Board and KSBE.³⁷ The theory of the minority trustees was that the Board would not be able to protect the best interests of KSBE because the

³¹ See discussion *infra* section II.B. for a discussion of the importance of the "entity theory" as it relates to the privilege elimination claim.

³² See, e.g., Stender's Reply, *supra* note 26, at 6.

³³ See *id.*

³⁴ See *id.*

³⁵ See Discovery Master's Order Granting Motion to Compel Deposition of Nathan Aipa, In re *Estate of Bishop*, Equity No. 2048, at 2 (Haw. Prob. Ct. Oct. 15, 1998) [hereinafter Discovery Master's Order].

³⁶ See Lindsey Removal Order, *supra* note 15; Rick Daysog, *Trustee Lindsey Removed*, HONOLULU STAR-BULLETIN, May 6, 1999, available at <<http://starbulletin.com/1999/05/06/news/story1.html>>.

³⁷ See Petition for Recusal, *supra* note 19, at 8-9.

IRS's charges involved a direct challenge to the past judgment of the Board.³⁸ The minority trustees argued for the limited removal of the trustees to preclude them from discharging their fiduciary duty to defend the Trust against the IRS's tax claims.³⁹ The probate court found merit in the limited removal claim and ordered the Board to cease directing KSBE's response to the tax deficiency claims.⁴⁰

C. Basic Considerations

Conflict of interest issues arise when a fiduciary, such as an attorney or a trustee, does not give undivided loyalty to the beneficiary of the fiduciary duty, such as a client or a trust, pursuant to goals set by the person establishing the fiduciary relationship, such as a client or trust settlor. When the fiduciary has an interest claiming his or her attention that conflicts with the beneficiary's interest, the law declares that the fiduciary must be removed.⁴¹ That conflicting interest can be the advancement of the fiduciary's own financial interests or the advancement of the interests of a third person.⁴²

Conflict claims against lawyer fiduciaries who cannot fulfill fiduciary duties owed to different clients whom they represent or have represented are said to be the most pervasively felt of all professional responsibility problems that affect lawyers.⁴³ Similarly, the obligation of a trustee to administer the trust solely for the benefit of the trust beneficiaries in accordance with the terms of the trust is a basic tenet of the law of trust administration,⁴⁴ and the fiduciary cannot personally profit at the expense of the beneficiary when administering the trust.⁴⁵ There is a well-drafted body of rules governing questions of conflicts of interest regarding lawyer fiduciaries,⁴⁶ and the case law prohibiting actual or apparent trustee self-dealing with trust property is well-developed.⁴⁷

³⁸ See *id.* at 8.

³⁹ See *id.*

⁴⁰ See Minute Order, *supra* note 22, at 6-7.

⁴¹ See BOGERT & BOGERT, *supra* note 3, § 543.

⁴² See *id.*

⁴³ See WOLFRAM, *supra* note 1, § 7.1.1.

⁴⁴ Section 170(1) of the Restatement (Second) of Trusts provides: "The trustee is under a duty to the beneficiary to administer the trust solely in the interest of the beneficiary." RESTATEMENT (SECOND) OF TRUSTS § 170(1) (1959).

⁴⁵ See *id.* § 170 cmt. a.

⁴⁶ See MODEL RULES OF PROFESSIONAL CONDUCT Rules 1.7-1.11, 1.13 (1995). These Rules and the previous rules on conflict of interest promulgated by the American Bar Association are discussed in WOLFRAM, *supra* note 1, §§ 7.1.2-7.4.3, 7.6.2-8.2.2, 8.3.1-8.10.3.

⁴⁷ The provision of the Restatement (Second) of Trusts prohibiting trustee self-dealing is quoted in *supra* note 44. That provision, section 170(1), has been applied in reported opinions

The duties of an attorney or trustee toward the beneficiary include advancing the interests of the beneficiary in all legal ways to best accomplish the objective of the fiduciary relationship.⁴⁸ The goal of an attorney-client relationship is dictated by the client to the attorney.⁴⁹ The duties of a trustee to administer the trust are governed by the "terms of the trust," a phrase adopted by the Restatement (Second) of Trusts, and therein defined as the legally provable intentions of the settlor of the trust.⁵⁰ The duty to advance the interest of the beneficiary is total and requires the best efforts of the fiduciary.⁵¹ Fiduciaries have a subsidiary duty to keep all confidential information learned from the beneficiary as well as any confidential communications between them.⁵² The conflict claims in the trustee removal action and the limited Board removal action impeded the trustees from fulfilling their duty to advance the interests of the beneficiaries, and the Board attorney's duty to keep confidential conversations with Board members regarding Board matters.

Consideration of the conflict claims is superficially complicated by the fact that KSBE is far from the usual trust. Everything from the great wealth it holds to the central place the trust holds in the economic and political life of Hawai'i means that KSBE has the potential to be the focus of great media attention. In the KSBE actions, that potential was fully realized. Application of rather cut-and-dried legal rules seemingly intended for private and much smaller fiduciary organizations may seem anomalous when an entity of the size and prominence of KSBE is involved. Nonetheless, the governing principles are clear, and are based upon sound policy judgments.

The applicable principles are readily available in Hawai'i law. Hawai'i has adopted a number of statutes and administrative regulations that address the issues presented by the privilege elimination claim. These include the American Bar Association Model Rules of Professional Conduct ("Model

more than 180 times since the provision was promulgated in 1959. See RESTATEMENT (SECOND) OF TRUSTS app. §§ 170 (1987 & Supp. 1999).

⁴⁸ See MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.2 (1995).

⁴⁹ See *id.* cmt. 1.

⁵⁰ See RESTATEMENT (SECOND) OF TRUSTS, §§ 4, 164 (1959) (stating that trustee's duties are established by the "terms of the trust" and defining that phrase). General rules of trust administration apply to a trustee only if there are no trust terms establishing the trustee's duties and powers. See *id.* § 164(b).

⁵¹ See *id.* § 170.

⁵² See Austin W. Scott, *The Fiduciary Principle*, 3 CAL. L. REV. 539, 553 (1949) ("A fiduciary in the course of his employment may acquire confidential information. It is a breach of his duty as fiduciary to use this information for his own purposes, or to communicate it to a third person who may so use it.").

Rules”),⁵³ the Hawai‘i Rules of Evidence (“HRE”),⁵⁴ and the Hawai‘i Probate Rules (“HPR”).⁵⁵ The Hawai‘i Supreme Court also has announced clear principles in several opinions to guide courts in conflict issues relating to KSBE.⁵⁶ Finally, accessible principles of general fiduciary law provide a firm answer to the limited Board removal action.

II. EVALUATION OF THE PRIVILEGE ELIMINATION CLAIM

A. *The Entity Theory and the Identity of the Client*

Identification of the client-beneficiary was the most important question in addressing the privilege elimination claim.⁵⁷ Specifically, the question was, who is the Board attorney’s client? If the client is the majority of the Board, the Board attorney has no attorney-client relationship with any individual Board member. If the Board attorney has an attorney-client relationship with individual Board members, then the Board attorney has no attorney-client relationship with the Board as a collective body.

The intent of the person establishing the fiduciary relationship is the most important consideration in fiduciary law.⁵⁸ Observing that principle in the

⁵³ See HAW. RULES OF PROFESSIONAL CONDUCT Rules 1.7-1.13 (addressing relevant conflict of interest issues). The Hawai‘i Rules of Professional Conduct are patterned after the Model Rules.

⁵⁴ HRE 503(b) provides:

(b) General rule of privilege. A client has a privilege to refuse to disclose and to prevent any other person from disclosing confidential communications made for the purpose of facilitating the rendition of professional legal services to the client (1) between the client or the client’s representative and the lawyer or the lawyer’s representative, or (2) between the lawyer and the lawyer’s representative, or (3) by the client or the client’s representative or the lawyer or a representative of the lawyer to a lawyer or a representative of a lawyer representing another party in a pending action and concerning a matter of common interest, or (4) between representatives of the client or between the client and a representative of the client, or (5) among lawyers and their representatives representing the same client.

HAW. R. EVID. 503(b).

⁵⁵ See HAW. PROB. R. § 42(a)-(d).

⁵⁶ See *Richards v. Midkiff*, 48 Haw. 32, 40, 396 P.2d 49, 55 (1964); see also *Takabuki v. Ching*, 67 Haw. 515, 695 P.2d 319 (1985).

⁵⁷ A consideration of any issue in fiduciary law requires identification of the fiduciary and the beneficiary of the fiduciary relationship. Both questions provide no difficulty in the majority of fiduciary relationships. When there is an identity question it almost always concerns the identification of the beneficiary.

⁵⁸ The Restatement (Second) of Trusts states that a trustee’s duties are established by the “terms of the trust.” RESTATEMENT (SECOND) OF TRUSTS § 164 (1959). That phrase is defined in section 4 of the Restatement as “the manifestation of intention of the settlor with respect to the trust expressed in a manner which admits of its proof in judicial proceedings.” *Id.* § 4.

context of the privilege elimination claim, it is clear that Princess Bishop intended for KSBE to carry out her specific intention to create and maintain the Kamehameha Schools.⁵⁹ For the trust to function in pursuit of that objective, the trustees must hire employees and agents, including attorneys, and direct their activities.⁶⁰

Princess Bishop was very clear on her intent in the event that the five member Board could not unanimously agree on a matter—she provided that a majority of the Board would make the decision on the matter.⁶¹ She obviously believed that the majority control concept was the most effective way the multiple trustee Board could manage KSBE to carry out her specific intention. Therefore, a majority, and only a majority, of the KSBE Board can hire an attorney and direct the attorney to protect the interests of KSBE.

The law of legal ethics, which is the same in Hawai'i on all relevant points as it is in general American jurisprudence, serves to implement the intentions of the settlor of a multiple trustee trust such as Princess Bishop. This is accomplished by the legal ethics concept of the "entity" theory. The theory, which has been uniformly adopted by commentators and modern appellate opinions,⁶² establishes that an attorney for an organization represents the governing body of the trust as an entity.⁶³ Since the governing body of KSBE has five members and must be directed by the majority of the Board, which consists of three or more trustees, the attorney for KSBE must take directions from a majority of the Board. Unless there are unusual circumstances,⁶⁴ the Board attorney functions for all practical purposes as the lawyer for the majority of the Board.

The entity theory is expressed in these terms in Rule 1.13 of the Hawai'i Rules of Professional Conduct ("HRPC"): "A lawyer employed or retained by an organization represents the organization acting through its duly authorized

⁵⁹ See *supra* note 6, and the portion of the Will quoted in the accompanying text.

⁶⁰ See BOGERT & BOGERT, *supra* note 3, § 555; see also *In re Bishop Estate*, 36 Haw. 403 (1943) (holding that trustees are entitled to incur reasonable expenses, chargeable to the trust estate, to hire administrative assistants to perform delegable duties which are reasonably necessary to the efficient administration of the estate).

⁶¹ See *Will*, *supra* note 6, art. 14.

⁶² See WOLFRAM, *supra* note 1, § 8.3.2, and cases cited therein; MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13(a) & cmts. 1-5 (1995); RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 26 & cmt. f (Proposed Final Draft No. 1 1996), and cases cited therein; Charles W. Wolfram, *Corporate-Family Conflicts*, 2 J. INST. STUD. LEGAL ETHICS 295, 307-21 (1999); Jeffrey N. Pennell, *Representations Involving Fiduciary Entities: Who Is the Client?*, 62 FORDHAM L. REV. 1319, 1334-41 (1994).

⁶³ See HAW. RULES OF PROFESSIONAL CONDUCT Rule 1.13.

⁶⁴ Unusual circumstances exist when the Board wishes to direct the organization in illegal conduct that is likely to result in substantial injury to the organization. In such a case, the organization's attorney may resign from representation of the organization. See *id.* Rule 1.13(c).

constituents.”⁶⁵ Comment 3 to HRPC 1.13, entitled “The Entity as the Client,” drives the point home by stating that when an organization’s lawyer interviews employees or “constituents” of the organization, “[t]his does not mean . . . that constituents of an organizational client are the clients of the lawyer.”⁶⁶ Comment 4 states: “When constituents of the organization make decisions for it, the decisions ordinarily must be accepted by the lawyer”⁶⁷

Turning to the law of evidence, HRE Rule 503(a)(1) states the entity theory in this fashion: “A ‘client’ is a person . . . or . . . organization or entity, either public or private, who is rendered professional legal services by a lawyer”⁶⁸ HPR Rule 42(a) states, “An attorney employed by a fiduciary for [a] . . . trust represents the fiduciary as client as defined in Rule 503(a) of the Hawaii Rules of Evidence and shall have all the rights, privileges, and obligations of the attorney-client relationship with the fiduciary”⁶⁹ In paragraph three of the commentary to HPR Rule 42, the drafters of the Rule expressly adopt the “lawyer client privilege” under HRE Rule 503, which explicitly adopts the entity theory.⁷⁰

The entity theory has also been adopted by the Hawai‘i Supreme Court, and has been applied by that court to KSBE under the synonym of the “collective trustee” concept.⁷¹ Collective trustee theory logically requires that the majority of the KSBE Board have sole and exclusive rights both to hire and direct attorneys and to either claim or waive the attorney-client privilege. Collective trustee theory also means that an individual trustee never has an individual attorney-client relationship with a KSBE attorney concerning KSBE matters. This basic principle of legal ethics is established by the general legal ethics concepts reviewed above and by two specific points of Hawai‘i law.

⁶⁵ *Id.* Rule 1.13(a).

⁶⁶ HAW. RULES OF PROFESSIONAL CONDUCT Rule 1.13 cmt. 3.

⁶⁷ *Id.* Rule 1.13 cmt. 4.

⁶⁸ HAW. R. EVID. 503(a)(1).

⁶⁹ HAW. PROB. R. 42(a). An assertion was made by one of the minority trustees in a discovery hearing that the use of the singular noun “fiduciary” in HPR 42(a) meant that each of the individual trustees had an individual attorney-client relationship with the Board attorney. *See* Letter from attorneys for trustee Oswald Kofoad Stender to Clyde Matsui, Discovery Master 2 (Oct. 2, 1998)(on file with author). The discovery master in the proceeding accepted this argument and ruled that, during the relevant period, there was a “joint attorney-client privilege among the trustees and Nathan Aipa as general counsel for KSBE” Discovery Master’s Order, *supra* note 35, at 2.

⁷⁰ *See* HAW. R. EVID. 503(a)(1).

⁷¹ *See* *Richards v. Midkiff*, 48 Haw. 32, 40-41, 396 P.2d 49, 55-56 (1964)(citing with approval *Mossman v. Damon*, 15 Haw. 401, 404 (1904)); *see also* *Takabuki v. Ching*, 67 Haw. 515, 526-28, 695 P.2d 319, 326-27 (1985). *Richards* is discussed *infra* in notes 81-83 and accompanying text.

The first of these points is stated in HRPC 1.13(a).⁷² That subsection states that a lawyer retained by an organization represents the organization.⁷³ While MRPC Rule 1.13(e) authorizes an organization's attorney to represent individuals owning, directing, or employed by the organization, such "dual representation" is only permissible if the interests of the individual client are not adverse to the interests of the organization under the usual test governing an attorney's ability to represent any new client.⁷⁴ Any representation of the trustee in connection with a position of the trustee contrary to a position taken by a majority of the Board would be professional misconduct under HRPC Rule 1.7, a rule referenced in HRPC Rule 1.13(e).⁷⁵

The second point has been stated on several occasions by the Hawai'i Supreme Court. A KSBE trustee who disagrees with the position taken by a majority of the Board cannot assert his or her position in a legal proceeding as the position of the KSBE.⁷⁶ A minority trustee is free to assert his or her position in a legal proceeding challenging Board action, but, when doing so, the minority trustee is not acting on behalf of the Board.⁷⁷ In the words of the Hawai'i Supreme Court, the minority trustee is "suing his fellow trustees to redress a breach of trust [and] is in effect bringing a derivative action on behalf of the beneficiaries of the trust."⁷⁸ In this situation, "one trustee has no standing to maintain an action on behalf of the trust estate as he alone cannot act in such representative capacity."⁷⁹

Furthermore, the Board attorney can never represent any person or group in an action against a majority of the Board under HRPC 1.7. For this reason, a minority trustee can never direct a Board attorney to take a legal position against a majority of the Board, and an individual trustee can never have an attorney-client relationship with a Board attorney concerning KSBE matters. No Board attorney could ethically represent an individual trustee in such a

⁷² See HAW. RULES OF PROFESSIONAL CONDUCT Rule 1.13(a).

⁷³ See *id.*

⁷⁴ Model Rule 1.13(e) makes any dual representation by an organization's attorney "subject to the provisions of Rule 1.7." MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13(e) (1995). That Rule prohibits an attorney from representing any new client with interests that are adverse to the interests of another client. See *id.* Rule 1.7(a). Rule 1.7 also prohibits an attorney from representing a new client if that representation "may be materially limited by the lawyer's responsibilities to the organization." *Id.* Rule 1.7(b). A lawyer may engage in dual representation if the organization gives informed consent to the representation, and the lawyer "reasonably believes" that the representation will not adversely affect the lawyer's representation of the organization.

⁷⁵ See HAW. RULES OF PROFESSIONAL CONDUCT Rule 1.13(e).

⁷⁶ See *Richards*, 48 Haw. at 40-41, 396 P.2d at 55; see also *Takabuki*, 67 Haw. at 526-28, 695 P.2d at 325-27.

⁷⁷ See *Richards*, 48 Haw. at 41-42, 396 P.2d at 55-56.

⁷⁸ *Id.* at 42, 396 P.2d at 56 (citing RESTATEMENT (SECOND) OF TRUSTS § 200 (1959)).

⁷⁹ *Id.*

situation under HRPC Rule 1.16(a), because to do so would “result in violation of the Rules of Professional Conduct [such as HRPC 1.7]”⁸⁰

Over thirty years ago, the Hawai‘i Supreme Court, having specifically reasserted the collective trustee concept, wrote about the collective trustee as if the majority of the KSBE Board were a single person. In *Richards v. Midkiff*, decided in 1964, the court noted the application of the collective trustee rule to KSBE, and, immediately afterward, stated: “The application of this rule is limited to situations where *the trustee* is attempting to exercise the powers conferred upon him.”⁸¹ Pursuant to collective trustee theory, the Hawai‘i Supreme Court thereby authorized the use of the singular noun “trustee” to describe the majority of the trustees of a trust.⁸²

The Hawai‘i Supreme Court’s use of the collective noun “trustee” to designate a majority of the Board provides an explanation for the reference in HPR Rule 42(a) to “the fiduciary” as the client of an attorney for a trust or estate. The Hawai‘i Attorney General and others arguing for the privilege elimination claim asserted that the use of the singular noun “fiduciary” in HPR Rule 42(a) meant that individual fiduciaries on a board of multiple fiduciaries of a trust, such as KSBE, have an individual attorney-client relationship with the attorney for the trust.⁸³ However, the use of the singular noun “fiduciary” in Rule 42 can carry no such meaning. It must be assumed that the drafters of Rule 42(a), who were trust specialists, were aware of the Hawai‘i Supreme Court’s use of the singular noun “trustee” in *Richards* to refer to a multiple person “collective trustee.” Common sense also dictates that the drafters sought to simplify the language of the rule, choosing to use the singular noun because most estates or trusts commonly have only one fiduciary.

With the use of the singular “fiduciary” in Rule 42(a) explained as consistent with the Hawai‘i Supreme Court’s adoption of the entity theory, as evidenced by its use of the term “collective trustee,” there is no other basis for contesting the application of the entity theory-collective trustee concept to the identification of the client of the Board attorney. When an attorney is retained by a trust, whose board of fiduciaries is split on a matter of policy, the client’s identity is clear. The rules of professional ethics, the law of evidence, and precedents of the Hawai‘i Supreme Court are in accord with the common sense requirement that a trust with a split board must be able to use and direct legal services. The client in that situation is the majority of the board of fiduciaries.

⁸⁰ HAW. RULES OF PROFESSIONAL CONDUCT Rule 1.16(a)(1).

⁸¹ *Richards*, 48 Haw. at 41, 396 P.2d at 55 (emphasis added).

⁸² *See id.*

⁸³ *See supra* note 69.

B. The Entity Theory and the Privilege Elimination Claim

The KSBE Board attorney never represented an individual trustee. That attorney's duties of representation and confidentiality were owed only to the Board as a "collective trustee" under the entity theory. Therefore, the fact that the minority trustees brought suit to remove a third trustee raised no issue concerning the application of the exception to the attorney-client privilege pertaining to disputes between former clients. No single trustee could have been a client of the Board attorney at any given time.

In Hawai'i and elsewhere, there is an exception from the attorney-client privilege for communications between an attorney and client when the client is seeking the assistance of the attorney for the purpose of perpetrating a crime or a fraud.⁸⁴ Thus, if any individual member of the Board had sought assistance from the Board attorney to commit a crime or tort on behalf of KSBE, the attorney-client privilege would not apply to communications engaged in furtherance of the crime. Under well-accepted procedures, the party who claims the privilege does not apply has the burden of producing evidence to the trial court.⁸⁵ However, the parties attacking the privilege in the trustee removal action never tendered or produced evidence that any member of the Board communicated with the Board attorney to seek assistance in accomplishing wrongdoing.

Finally, due to the fiduciary status of the trustees, HPR Rule 42(c) provides that the attorney for a trust, such as the Board attorney, has an independent duty to inform the probate court if the attorney "knows" of the commission or possible commission of a crime that could injure the trust.⁸⁶ This rule imposes on the trust attorney a duty to inform that goes beyond the usual obligation of an attorney to report false statements made in a proceeding.⁸⁷ Public records,

⁸⁴ See HAW. R. EVID. 503(d)(1).

⁸⁵ See *United States v. Zolin*, 491 U.S. 554, 572 (1989).

⁸⁶ See HAW. PROB. R. § 42(c). HPR Rule 42(c) provides:

An attorney for an estate, guardianship, or trust is an officer of the court and shall assist the court in securing the 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 such as accountings and the closing a probate estate are performed timely. The attorney, after prior notice to the fiduciary, shall have an obligation to bring to the attention of the court the nonfeasance of the fiduciary.

Id.

⁸⁷ The Model Rules require attorneys to inform a court of certain information if the attorney is appearing before the tribunal. This information includes "a material fact . . . when disclosure is necessary to avoid assisting a criminal or fraudulent act by the client" and facts that are necessary as a reasonable "remedial measure[]" when the lawyer discovers he or she has offered evidence in court "that the lawyer knows to be false." MODEL RULES OF PROFESSIONAL CONDUCT Rules 3.3(a)(2), (a)(4) (1995). A lawyer is also required to disclose "all material facts known to the lawyer which will enable the tribunal to make an informed decision" in an *ex parte*

court transcripts, and media reports of the privilege elimination proceedings contain no indication that a Board attorney made any report of a possible commission of a crime of any type.

The attorney-client privilege represents a basic policy of Anglo-American law to promote full and frank communication between clients and attorneys in order to make available the best legal advice possible. Few organizations need such legal advice more than large fiduciary organizations, with myriad activities in many fields of endeavor.

Based upon the trial court's ruling on the privilege elimination claim, all that is necessary for a retroactive removal of the privilege is the assertion by one trustee in a trust having multiple trustees that another trustee should be removed. The trial court failed to pursue the most traditional route for ousting the privilege and did not require a showing to establish the exception to the attorney client privilege for crime-fraud communications.⁸⁸ Therefore, it is

proceeding. *Id.* Rule 3.3(d). HPR Rule 42(c) does not require that a lawyer be involved in a proceeding in any court before the duty to disclose arises. *See* HAW. PROB. R. 42(c).

⁸⁸ The trial court also failed to require any consideration of the type a few courts have authorized under the controversial opinion in *Garner v. Wolfinbarger*, 430 F.2d 1093 (5th Cir. 1970). In *Garner*, the shareholders of a corporation sued the corporation and its officers alleging fraud in the corporation's sale of its stock to the shareholder plaintiffs. The corporation claimed the attorney-client privilege shielded any communications between the officer defendants and the corporation's attorney. The court held that the privilege could be asserted by the corporation, but the plaintiffs could gain access to the communications if they made a showing of good cause. The court noted that the previously "absolute" attorney-client privilege was qualified in certain corporate shareholder dispute situations. *See id.* at 1100-03.

Garner considered both the joint client dispute and crime/fraud exceptions to the attorney-client privilege and held that neither applied. The court was mindful of the obligation the corporation management owed to shareholders and considered it against public policy to allow management to stand "behind an ironclad veil of secrecy which under all circumstances preserves it from being questioned by those for whom it is, at least in part, exercised." *Id.* at 1101.

The indicia to be considered to determine if the plaintiff shareholders had shown good cause included: the percentage of the corporation's stock the plaintiffs held; whether the claim of fraud is "obviously colorable" (meaning likely to prevail unless controverted); the necessity of obtaining the information from the privileged communications; the criminality of the alleged actions of the corporate officers; and the risk of revealing sensitive information such as trade secrets. *See id.* at 1104.

The *Garner* approach to the attorney-client privilege in suits by shareholders against corporate directors has been adopted by the Fourth Circuit in *Sandberg v. Virginia Bankshares, Inc.*, 979 F.2d 332, 348 (4th Cir. 1992), the Fifth Circuit in *Ward v. Succession of Freeman*, 854 F.2d 780, 784 (5th Cir. 1988), and the Sixth Circuit in *Fausek v. White*, 965 F.2d 126, 129-30 (6th Cir. 1992). On the other hand, the *Garner* approach has been heavily criticized. The most thorough academic study of the *Garner* concept concluded that "*Garner's* exception to the privilege should be reexamined and rejected." Stephen A. Saltzburg, *Corporate Attorney-Client Privilege in Shareholder Litigation and Similar Cases: Garner Revisited*, 12 HOFSTRA L. REV. 817, 848 (1984).

not an exaggeration to say that the mere allegation that a fiduciary in a multiple fiduciary organization should be removed would eliminate the attorney-client privilege for communications between the organization and its attorney. Unless rejected, the trial court ruling will force fiduciaries to avoid any type of confidential communication with the attorney for the organization in which the fiduciary serves. Such would truly be a perverse result.

III. EVALUATION OF THE LIMITED BOARD REMOVAL CLAIM

A. *The Conceptual Basis of the Claim*

The limited Board removal action was instituted in the probate court by the minority trustees in January 1999.⁸⁹ The minority trustees never made clear the exact nature of the conflict of interest between members of the Board and the Trust. Their petition to the court merely stated:

Trustees Stender and Jervis have been informed and believe that there is a potential and/or actual conflict of interest now existing or hereafter arising as to all of the Trustees with respect to the [IRS] Audit. As a result, Trustees Stender and Jervis believe it is in the best interest of the Trust Estate for *all* Trustees to recuse themselves with respect to exercising any trust powers related to the Audit.⁹⁰

In their moving papers, the minority trustees presented no evidence relevant to their claim of conflict and did not elaborate on the alleged "potential and/or actual conflict of interest."⁹¹

Regardless of the wisdom of the *Garner* approach, the factors considered in that opinion were not mentioned in the privilege elimination claim. However, *Garner* shows how a small number of federal jurisdictions have altered the traditional approach to the attorney-client privilege in a corporation context. Under that view, in situations in which the privilege could be used to defeat justice and a strong case has been made by the opponent of the privilege, the privilege will no longer be considered absolute.

⁸⁹ See Petition for Recusal, *supra* note 19; see also Rick Daysog, *Judge to Rule on Trustees' Conflict of Interest*, HONOLULU STAR-BULLETIN, Jan. 30, 1999, at A-3. The conflict claim was apparently based upon an earlier recommendation made by the Special Master appointed to review the consolidated accounting of KSBE. See Petition for Recusal, *supra* note 19, at 5.

⁹⁰ Petition for Recusal, *supra* note 19, at 8 (emphasis in original).

⁹¹ See Trustee Oswald Kofoad Stender's Reply Memorandum to Trustees Richard Sung Hong Wong's, Henry Haalilio Peters', and Marion Mae Lokelani Lindsey's Objection and Response to Trustees Oswald Kofoad Stender and Gerald Aulama Jervis' Petition for Approval of Voluntary Recusal with Respect to Pending Tax Audit and for Appointment of a Panel of Special Administrators with Respect to Pending Tax Audit, In re *Estate of Bishop*, Equity No. 2048, at 9 (Haw. Prob. Ct. Feb. 2, 1999). Without elaboration, Trustee Jervis basically cited case law supporting the ability of the court to appoint special administrators, known as "trustees ad litem," where the trustees' personal interest in a particular matter conflicts with that of the trust or beneficiaries. See Trustee Gerard Aulama Jervis' Supplemental Memorandum Re: (1)

The Minute Order of the court granting the minority trustees' petition provided the most complete allegation of the conflict claim:

Based on the IRS Forms 5701⁹² received by the Trust Estate and its subsidiaries, the Court finds and concludes that actual, apparent, adverse and material conflicts of interest exist between the individual interests of Trustees of the Trust Estate . . . and the interests of the Trust Estate with respect to the claims and issues raised in the IRS Forms 5701 and the IRS Audit.⁹³

As an example of "an actual, apparent, adverse and material conflict of interest" between the trustees and the Trust, the court pointed to the fact that the IRS proposed an "adjustment to the Trust Estate which is based on the payment of excessive or unreasonable compensation to the Trustees of the Trust Estate."⁹⁴

The above suggests that the conflict claim in the limited Board removal action amounted to no more than the proposition that a third party can create a conflict of interest between a trustee and a trust when it asserts that the trustee, acting on a behalf the trust, committed a mistake or wrongful act for which the trust or the trustee could be held liable. The result of such an alleged conflict is that the trustee must be removed from settling or supervising the response by the trust to the third-party allegation. Essentially, the principle on which the conflict claim was based would mandate that if a trustee is potentially liable to the trust for conduct that exposes the trust to liability, he or she cannot supervise the trust's response to third-party claims against the trust arising from such conduct. For good reasons, well-settled trust law completely rejects the idea that potential trustee liability establishes a conflict of interest.⁹⁵

The basic misconception in this argument, which the court accepted in the limited Board removal action, is that the trustees' potential malfeasance in responding to a third-party claim for which they may be personally liable will always warrant their removal, even if that meant disregarding the settlor's

Trustees Oswald Kofoad Stender and Gerard Aulama Jervis' Petition for Approval of Voluntary Recusal with Respect to Pending Tax Audit and for Appointment of a Panel of Special Administrators with Respect to Pending Tax Audit (filed 1/21/99) and (2) Trustees' Petition for Instructions and Approval of Appointment of IRS Dispute Advisory Panel (Filed 1/22/99), In re *Estate of Bishop*, Equity No. 2048, at 2-4 (Haw. Prob. Ct. Feb. 1, 1999).

⁹² The IRS Form 5701 documented the claims of tax deficiencies made by the IRS.

⁹³ Minute Order, *supra* note 22, at 6.

⁹⁴ *Id.* The court also noted that trustee Stender had alleged that all of the trustees had been advised that the IRS at that time expected to issue Notices of Proposed Adjustments (IRS Form 5701) to one or more individual trustees in the near future. *See id.*

⁹⁵ *See* discussion *infra* section III.B.

intentions and choice of trustees.⁹⁶ This would mean that any assertion of a claim against a trust by a third party would result in the limited removal of the trustees, as long as it is possible to imagine a theory on which the trustees might have ultimate liability to the trust for the claim. Because a trustee is liable to a trust for any negligent act of the trustee that results in harm to the trust,⁹⁷ it will usually be possible to conceive of allegations of trustee negligence in connection with even the most mundane claims by third parties against the trust.⁹⁸

B. Trust Law and the Potential Trustee Liability Concept of Conflicting Interests

A trustee always has the right to defend his or her stewardship of the trust, and the fact that a trustee may have some personal interest in that defense does not create a conflict of interest.⁹⁹ Trustees commonly defend or supervise the defense of a trust against claims attacking the trustees' management of the trust. This right to defend is recognized in the Uniform Trustee Powers Act,¹⁰⁰ which is the law of Hawai'i¹⁰¹ and fifteen other states.¹⁰² The right is also

⁹⁶ Where a trustee specifically chosen by the settlor has died or otherwise has become unable to function as trustee, the successor trustee will also be considered specifically chosen by the settlor if the appointment was made pursuant to the settlor's prescribed method for selecting successor trustees. See 2 SCOTT & FRATCHER, *supra* note 1, § 108.3. This principle applies directly to the Will of Princess Bishop. See *Will*, *supra* note 6, art. 14 (directing "that vacancies shall be filled by the choice of a majority of the Justices of the Supreme Court, the selection to be made from persons of the Protestant religion.").

⁹⁷ See RESTATEMENT (SECOND) OF TRUSTS §§ 201, 205 (1959). Comment b to section 201 of the Restatement (Second) of Trusts specifies that a trustee commits a breach of trust if the trustee acts negligently. See *id.* § 201 cmt. b. Section 205 establishes the liability of a trustee to a trust for any breach of trust by the trustee that causes loss to the trust. See *id.* § 205.

⁹⁸ E.g., assume a trust employee allegedly operates an automobile in a negligent manner while on trust business, thereby causing an accident that injures a third party. If it is possible to allege that the trustee of the trust negligently hired the employee by not first investigating the driving history of the employee, the trustee faces potential personal liability to the trust for the amount of the claim the trust has to pay to the injured third party.

⁹⁹ See *Bank of Am. Nat'l Trust & Sav. Ass'n v. Long Beach Fed. Sav. & Loan Ass'n*, 297 P.2d 443, 448 (Cal. Dist. Ct. App. 1956).

¹⁰⁰ The wording of the Uniform Trustees' Powers Act is: "a trustee has the power . . . to prosecute or defend actions, claims, or proceedings for the protection of trust assets and of the trustee in the performance of his duties . . ." UNIF. TRUSTEES' POWERS ACT § 3(c)(25), 7B U.L.A. § 748 (1985).

¹⁰¹ See the identical language in HAW. REV. STAT. § 554A-3(c)(24) (Supp. 1999).

¹⁰² For a list of the states, see UNIF. TRUSTEES' POWERS ACT Table of Jurisdictions Wherein Act Has Been Adopted, 7B U.L.A. 741 (Supp. 1999).

recognized as the settled rule by the leading commentators on fiduciary law¹⁰³ and the Restatement (Second) of Trusts.¹⁰⁴ Not only is there no "conflict of interest" between the trustee's defense of his or her stewardship and the interests of the trust, but trustees are authorized to collect their reasonable expenses in successfully making such a defense.¹⁰⁵

The principle that the intent of the settlor must be followed dictates that a trustee must have the right to direct the trust's response to third party claims even though the trustee is potentially liable.¹⁰⁶ If the settlor intended that a particular trustee or a trustee chosen by a specific procedure should manage the affairs of the trust, that intention should be followed. That basic principle applies absent actual proof that the trustee is incapable of carrying out the settlor's intentions.¹⁰⁷

A trustee must have a personal interest actually adverse to the interest of the trust before being required to petition the court for permission to exercise his or her right to defend. This is the requirement under Hawai'i Revised Statutes ("HRS") section 554A-5(b).¹⁰⁸ Actions requiring court approval under that subsection must meet a difficult standard—only situations in which a trustee may gain a cognizable financial advantage at the expense of the trust meet the standard.¹⁰⁹ If the trustee does not actually have an interest adverse to the

¹⁰³ See 2A SCOTT & FRATCHER, *supra* note 1, § 178 ("[A trustee] should defend actions brought against him that if successful would cause a loss to the trust estate."); see also BOGERT & BOGERT, *supra* note 3, § 581.

¹⁰⁴ See RESTATEMENT (SECOND) OF TRUSTS § 178 (1959).

¹⁰⁵ See *Grey v. First Nat'l Bank in Dallas*, 393 F.2d 371, 387 (5th Cir. 1958); *Weidlich v. Comley*, 267 F.2d 133, 134 (2d Cir. 1959); *Jessup v. Smith*, 119 N.E. 403, 404 (N.Y. 1918); see also 3 SCOTT & FRATCHER, *supra* note 1, § 188.4.

¹⁰⁶ See 2A SCOTT & FRATCHER, *supra* note 1, § 164.1; RESTATEMENT (SECOND) OF TRUSTS § 164(a) (1959).

¹⁰⁷ See 2 SCOTT & FRATCHER, *supra* note 1, §§ 107, 107.1; RESTATEMENT (SECOND) OF TRUSTS § 107(a), § 107 cmt. b (1959).

¹⁰⁸ HRS § 554A-5(b) provides:

(b) If the duty of the trustee and the trustee's individual interest or the trustee's interest as trustee of another trust, 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. Under this section, personal profit or advantage to an affiliated or subsidiary company or association is personal profit to any corporate trustee.

HAW. REV. STAT. § 554A-5(b) (1993).

¹⁰⁹ See, e.g., *Keye v. Gautier*, 684 So. 2d 210 (Fla. Dist. Ct. App. 1996) (per curiam) (upholding summary judgment against trustee alleged to be in violation of Florida's equivalent of HRS § 554A-5(b)). Citing *GEORGE G. BOGERT & GEORGE T. BOGERT, THE LAW OF TRUSTS AND TRUSTEES* § 453(J) (2d ed. 1993), the opinion held that court approval was necessary for a trustee's decision to lend funds to himself from the trust corpus without giving the trust a security interest to secure repayment. See *Keye*, 684 So. 2d at 211.

trust, he or she is free to act without court approval and the settlor's intent in designating this person as the fiduciary prevails.

As long as the interest of the trustee and the trust coincide or reinforce each other, there is no conflict of interest. Such was the case of KSBE with respect to the IRS claims. Both the trustees, whose judgment in tax law matters was implicated, and the trust stand to benefit from the defeat of the tax claims. The interests of KSBE and the Board are actually identical, rather than conflicting. The legal reasoning stated by Judge Learned Hand in *Weidlich v. Comley*¹¹⁰ is definitive on this point. Judge Hand had before him a claim that a trustee invariably had a conflict of interest in using trust funds to defend himself from charges of malfeasance.¹¹¹ Judge Hand wrote:

That completely misses the true situation: a trustee was appointed to administer the assets; the settlor selected him to do so, and whatever interferes with his discharge of his duty pro tanto defeats the settlor's purpose. 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.¹¹²

The law of trusts adequately protects the interests of trust beneficiaries in the situation in which a trustee defends the trust from a claim for which he or she may be personally liable. If any of the IRS claims are eventually validated, and if any valid claim indicates malfeasance on the part of a member of the KSBE Board, there are adequate remedies available to protect the interests of the Trust at that time. A surcharge action can be brought¹¹³ and a removal action will lie against the trustee or trustees who were guilty of malfeasance.¹¹⁴ Furthermore, if there was any proof of trustee wrongdoing that gave the court reasonable doubt about the ability and probity of the trustees to supervise KSBE's response to the IRS claims, interim removal was also an option.¹¹⁵ The presence of any evidence of wrongdoing or the trustees' lack

¹¹⁰ 267 F.2d 133 (2d Cir. 1959).

¹¹¹ See *id.* at 134.

¹¹² *Id.*

¹¹³ See HAW. REV. STAT. § 560:7-306 (1993); BOGERT & BOGERT, *supra* note 3, § 862; 3 SCOTT & FRATCHER, *supra* note 1, § 205; RESTATEMENT (SECOND) OF TRUSTS § 205 (1959).

¹¹⁴ See HAW. REV. STAT. § 560:7-305 (1993); BOGERT & BOGERT, *supra* note 3, § 861; 2 SCOTT & FRATCHER, *supra* note 1, § 107; RESTATEMENT (SECOND) OF TRUSTS § 107(a), § 107 cmts. a & b (1959).

¹¹⁵ According to the Restatement (Second) of Trusts section 107, comments a and b, a court with jurisdiction over a trust may remove the trustee "if his continuing to act as trustee would be detrimental to the interests of the beneficiary[.]" including those situations in which the court finds the trustee unfit due to "old age, habitual drunkenness, [and] want of ability or other cause" RESTATEMENT (SECOND) OF TRUSTS § 107 cmts. a & b (1959). "The matter is one for the exercise of a reasonable discretion by the court." *Id.* § 107 cmt. a.

of ability or probity would justify the invocation of such a remedy by the minority trustees or the court on its own motion.¹¹⁶

The important point here is that any accusation of trustee malfeasance must be proven to the court through the introduction of evidence.¹¹⁷ Allowing trustee removal on the basis of allegations of speculative and potential conflicts of interest severely derogates the intentions of the settlor as to who is authorized to manage the assets of the trust.

CONCLUSION

This Article discussed two conflict claims made in two proceedings in the KSBE litigation. While both claims were sustained by the probate court, neither had merit and both undermine important fiduciary relationships. The controversy and notoriety of the legal actions involving KSBE should in no way obscure the fact that the conflict claims discussed in this Article strike at the heart of the law of fiduciary relationships. That law has proven to be effective for the myriad fiduciary relationships that are taken for granted in the American legal system. To protect the ability of individuals to choose lawyers and trustees effectively, both claims should be unequivocally rejected through appellate procedures and by academic commentary.

¹¹⁶ As a leading authority on trusts notes:

It might also prove useful if the court could suspend or remove [a trustee] for a brief time. . . . [T]he court's power to suspend seems to exist, at least where an investigation of the grounds of removal takes considerable time and there is evidence indicating a danger of waste or misappropriation pending the proceedings.

BOGERT & BOGERT, *supra* note 3, § 528.

¹¹⁷ "Evidence which merely shows a decrease in the value of the trust property, without showing that the trustee wrongfully caused the decrease, does not make a case [for removal of a trustee]." BOGERT & BOGERT, *supra* note 3, § 871.

