

Possible Privilege Pitfalls

The Fiduciary Exception to the Attorney-Client Privilege

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Managing risk requires relying upon the advice of counsel. Although the attorney-client privilege protects the confidential communications between lawyer and client made in the course of legal representation,¹ its protections are not absolute. Professional fiduciaries are at particular risk of the disclosure of their presumed confidential communications with counsel under what is known as the “fiduciary exception” to the attorney-client privilege. Understanding the fiduciary exception is critical to avoiding its grasp.

Riggs and the Rise of the Fiduciary Exception

Although the notion of the fiduciary exception to the attorney-client privilege did not arise in Delaware,² the seminal case on its application to trustees of common law trusts came from our own Delaware Court of Chancery. In the 1976 case *Riggs National Bank of Washington D.C. v. Zimmer*,³ which the U.S. Supreme Court in 2011 called “the leading American case on the fiduciary exception,”⁴ the Court of Chancery weighed a claim by trust beneficiaries to surcharge the trustees for alleged breaches of trust with respect to certain tax matters. In the prosecution of their claim, the beneficiaries sought a legal memorandum prepared by the trustees’ outside

counsel on this topic.⁵ The trustees resisted this request on the basis that the memorandum was the product of confidential communications between the trustee and his attorneys for the purpose of securing legal assistance, and thus was protected by the attorney-client privilege. Because the memo constituted the work product of their attorney prepared in contemplation of potential tax litigation with the State of Delaware, the trustees argued, it was entitled to work-product immunity.⁶

The Court rejected both contentions, finding instead that the memorandum was prepared ultimately for the benefit of the beneficiaries of the trust and *not* for the purpose of the trustees' own defense in any litigation.⁷ The Court reasoned that the attorney-client privilege did not apply to shield the communication from the beneficiaries because, as a fiduciary representative for the beneficiaries, the trustee was not the real client in the sense that the trustee's personal interests were being served by the advice rendered.⁸ Rather, the Court found that the very intention of the memorandum was to aid the beneficiaries, and it thus could not be protected from them.⁹

In a somewhat closer call, the Court declined to extend attorney work-product protection to the memorandum, holding that the beneficiaries, rather than the trustees, were the attorney's ultimate clients because the advice was for the ultimate benefit of the beneficiaries rather than the trustees themselves.¹⁰ The purpose of the work product doctrine is not to protect the client, but rather, the attorney. The underlying policy is to protect the privacy of lawyers in their work and encourage the freedom of lawyers from interference in the task of preparing their clients' cases for trial.¹¹ The work product doctrine is not absolute, and can be overcome where the party seeking such documents demonstrates a "substantial need" for their production that could not otherwise be satisfied without undue hardship.¹² Here, the Court found that the beneficiaries had substantial need of the memorandum, and the trustees were ordered to turn it over.¹³

Tellingly, the *Riggs* court focused on who paid the lawyers. That they were paid from the trust was "a significant factor, not only in weighing ultimately whether the beneficiaries ought to have access to the document, but also it is in itself a strong indication of precisely who the real clients were."¹⁴ As counsel fees came from the trust, the Court noted, the beneficiaries effectively paid for the memorandum, and if it were indeed prepared for the benefit of the trustees, charging the trust may have been improper.¹⁵

Mennen and the Current State of the Fiduciary Exception

Delaware courts had little to say on the fiduciary exception until its return to the forefront in *Mennen v. Wilmington Trust Co.*,¹⁶ in which the beneficiaries sought to compel the trustees to produce all of the institutional trustee's communications with counsel related to an earlier action where the institutional trustee had petitioned the Court for instructions and for the removal of the individual trustee. The beneficiaries also sought "production of legal 'advice and documents related to [the institutional trustee's] duties and powers' under the Trust agreement."¹⁷ The beneficiaries argued that these documents were prepared for their ultimate benefit, rather than the trustees' benefit, and were thus

subject to the fiduciary exception to the attorney-client privilege under *Riggs*.¹⁸

Over the trustees' objections, the Court determined that *Riggs* remains good law in Delaware,¹⁹ and helpfully distilled the *Riggs* holding, and the subsequent federal cases discussing it, into several factors for courts to consider in determining whether the fiduciary exception should apply. These include: (i) the purpose of the legal advice; (ii) whether litigation was pending or threatened between the trustee and the beneficiaries when the advice was obtained; and (iii) the source from which the fees for the legal advice were paid.²⁰

Evaluating the circumstances of the *Mennen* case in light of these factors, the Court ruled that the documents relating to the earlier petition for instructions by the institutional trustee were largely protected, whereas documents relating to the trustee's powers and responsibilities were not.²¹

The Court's analysis in finding that the bank trustee need not disclose documents relating to the earlier petition is instructive to all trustees. Applying the first factor, the Court agreed with the institutional trustee that it sought the advice on its own behalf and not on behalf of the beneficiaries.²² The trustee acted foremost in its own interests, and any potential benefit conferred upon the beneficiaries through its actions was ancillary.

Second, the Court concluded that the institutional trustee reasonably anticipated a threat of litigation with the beneficiaries.²³ As the Third Circuit explained, the *Riggs* court, in finding that the advice in question was for the ultimate benefit of the beneficiaries, placed significance on the fact that the trustee lacked "a legitimate personal interest in the legal advice obtained."²⁴ A finding that the trustee had a legitimate personal interest in legal advice does not require pending litigation against the trustee, according to the Court in *Mennen*; rather, the determination must be made in light of all of the facts at hand, which seems to include the trustee's reasonable anticipation of litigation with the beneficiaries.²⁵ In this case, that occurred when the company comprising the trust's largest investment went bankrupt.²⁶

Third, the institutional trustee paid for the legal advice in these matters rather than charging it to the trust. Under *Riggs*, each of these three factors weighs in favor of a finding that the trustee was the real client and that the privilege should therefore be preserved. The Court accordingly denied the beneficiaries' motion to compel with respect to privileged documents pertaining to the trustee's exposure or prepared in connection with or in anticipation of litigation, including the earlier action.²⁷ However, the Court ordered the disclosure of otherwise privileged documents pertaining to the trustees' powers and responsibilities under the terms of the trust unless prepared in connection with litigation, finding that, under *Riggs*, "[a] beneficiary is entitled to inspect opinions of counsel procured by the trustee to guide him in the administration of the trust" and that beneficiaries must have "knowledge of the affairs and mechanics of the trust management" in order for them to hold the trustee to the proper standards of care and honesty.²⁸

(continued on p. 16)

(continued from p. 15)

Takeaways for Trustees

a. Look out for your own interests.

It may seem counter-intuitive, but by openly acting in its own interests in seeking the advice of counsel, an institutional trustee may be afforded the protection of the attorney-client privilege to shield its communications with counsel. Cynical though it may sound, a trustee should consider the possibility of conflict with one or more beneficiaries in every action it takes and anticipate claims by those beneficiaries. Where possible, a trustee should frame even actions ostensibly taken on behalf of the beneficiaries as being in the trustee's best interest – after all, the failure to take action for the good of the beneficiaries could expose the trustee to liability at the hands of the beneficiaries. Otherwise, even the most altruistic trustee could find itself on the receiving end of a suit in which the very beneficiaries it sought to benefit may use the trustee's own communications with counsel against it. No good deed goes unpunished.

b. Where appropriate, foot the bill.

The third factor in the *Riggs* test is not dispositive, and in fact Delaware law con-firms that a trustee's retention of counsel, and its payment of counsel's fees out of trust funds, does not alone operate as a waiver of the attorney-client privilege.²⁹ However, where the trustee's conduct is at issue, the trustee may be wise to pay costs of legal counsel out of its own pocket rather than from the trust, and the reasons extend beyond strengthening the trustee's claim to privilege under the *Riggs* test. For instance, it may be politically expedient in order to avoid further riling already aggrieved beneficiaries, or to show deference to the tribunal, which has ultimate authority over the payment of attorneys' fees in trust actions.³⁰ A trustee can always later seek to have its attorneys' fees reimbursed from the trust if the situation warrants.



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Notes:

- 1- See Delaware Uniform Rule of Evidence 502(b) for Delaware's statement of the attorney-client privilege. This bedrock principle of the common law system is designed to promote candor and allow clients to obtain legal advice, assessing both strengths and weaknesses, without fear of compelled disclosure. See generally Hazard, Jr., Geoffrey C., *An Historical Perspective on the Lawyer-Client Privilege*, 66 CAL. L. REV. 1061, 1069-91 (1978).
- 2- See, e.g., *Garner v. Wolfenbarger*, 430 F.2d 1093, 1103-04 (5th Cir. 1970) (holding that "where the corporation is in suit against its stockholder on charges of acting inimically to stockholder interests, protection of those interests as well as those of the corporation and of the public require that the availability of the privilege be subject to the right of the stockholders to show cause why it should not be invoked in the particular instance").
- 3- 355 A.2d 709 (Del. Ch. 1976) (Chancellor William T. Quillen).
- 4- *United States v. Jicarilla Apache Nation*, 131 S. Ct. 2313, 2321 (2011).
- 5- *Id.* at 710.
- 6- *Id.*
- 7- *Id.* at 711.
- 8- *Id.* at 713.
- 9- *Id.* at 713-14.
- 10- *Id.* at 716.
- 11- *Id.* at 714-15 (citing *Hickman v. Taylor*, 329 U.S. 495, (1947); *Duplan Corp. v. Moulinage et Retorderie de Chavanoz*, 487 F. 2d 480 (4th Cir. 1973); *Republic Gear Co. v. Borg-Warner Corp.*, 381 F.2d 551 (2d Cir. 1967)).
- 12- See Ct. Ch. R. 26(b)(3).
- 13- *Riggs*, 355 A.2d 709 at 716.
- 14- *Id.* at 712.
- 15- *Id.*
- 16- *Mennen v. Wilmington Trust Co.*, 2013 WL 4083852 (Del. Ch. July 25, 2013) (Master's Final Report, adopted by Order dated August 12, 2013).
- 17- *Id.* at *2.
- 18- *Supra*, note 5.
- 19- The trustees had asserted that the Delaware Supreme Court's adoption of Rule 502 of the Delaware Uniform Rules of Evidence and its statement of the attorney-client privilege abrogated the common law exception in *Riggs*, a contention the Court dismissed. *Mennen*, 2013 WL 4083852, at *3.
- 20- *Id.* at *4 (citing *Riggs*, 355 A.2d at 711-12; *Jicarilla*, 131 S. Ct. 2313, 2322 (2011) (listing these three factors as the basis for the determination of who the "real client" was in *Riggs*); *Wachtel v. Health Net, Inc.*, 482 F.3d 225, 232 (3d Cir. 2007) (listing the same three factors)).
- 21- *Mennen*, 2013 WL 4083852, at *10.
- 22- *Id.* at *4-5.
- 23- *Id.* at *5.
- 24- *Id.* (citing *Wachtel*, 482 F.3d at 232).
- 25- *Mennen*, 2013 WL 4083852 at *5.
- 26- *Id.*
- 27- *Id.* at *10.
- 28- *Id.* at *7.
- 29- *Id.* at *5 (citing 12 Del. C. § 3333).
- 30- 12 Del. C. § 3584 ("In a judicial proceeding involving a trust, the court, as justice and equity may require, may award costs and expenses, including reasonable attorneys' fees, to any party, to be paid by another party or from the trust that is the subject of the controversy").