The Trustee, The Beneficiary, and The Letter of Wishes -
Be Careful What You Wish For

By: Alexander A. Bove, Jr., Esq.

[Published in Trusts & Estates, (Primedia, January 2006)]

Upon accepting a trust, the trustee is given the following statement, signed by the settlor of the trust:

> "To my Trustee:[1] I offer you the following observations, opinions, and wishes in an effort to assist and guide you in the process of exercising your discretion in the making or withholding of distributions to the beneficiaries in the administration of my trust. I want to give you some insight into my preferences in the beneficiaries' use and application of the trust funds, how liberal or strict I wish you to be, and what I might decide in similar circumstances. Please understand that the guidance and wishes stated here are merely that - my wishes. They are expressions that I ask you only to take into due consideration in the exercise of your discretion and are in no way intended to be legally binding on you as Trustees. Furthermore, despite the wishes I express here, since they are not intended to be binding on you, I realize that the exercise of your discretion may not always be consistent with them. In addition, please note that I consider this statement to be confidential, and I direct that it not be disclosed to any beneficiary.[2]
>
> "Where discretionary payments of income are concerned, I prefer that current beneficiaries who show financial responsibility (e.g., not excessive debt, good credit history, and gainful employment where applicable) be given preference and receive distributions of most or all of the trust income rather than have the trust

accumulate such income for future beneficiaries and remaindermen. Of course, the special needs of all beneficiaries are to be considered at all times.

"Where discretionary payments of principal are concerned, my wish is that your discretion be exercised liberally, as it is my clear intention that my children and grandchildren use and enjoy my estate (trust funds), giving preference to my children, rather than preserving as much as possible for future remaindermen. For instance, I approve of principal distributions to assist a child (or grandchild) in purchasing of a residence, starting a business, getting married, furthering his or her education, purchasing an automobile, or taking a vacation. In making distributions for education I would include costs of travel and living expenses (anywhere in the world), and for vacations, I would include costs of accompanying family members who may not be named as beneficiaries, and where applicable, vacation distributions may also cover costs of the guardian of the beneficiary and the guardian's immediate family members. In addition, if the beneficiary is under guardianship, distributions benefiting the beneficiary's guardian may be made if you feel they will directly or indirectly benefit the beneficiary (for instance, improvement of the guardian's home where the beneficiary is living there.)

"In sum, since you are in large part acting as my surrogate in administering these funds for my family's benefit, it is my hope and belief that the foregoing wishes and illustrations will assist you in your decisions."

//S// Samuel Settlor

The foregoing is what is known as a non-binding letter of wishes.[3] It is designed to offer the trustees of a discretionary trust some guidance in the exercise of their discretion. A statement such as this where actually written by a non-attorney settlor may contain inconsistencies and raise questions, but it would nevertheless be immensely helpful to a trustee in ascertaining the settlor's state of mind and purposes in establishing the discretionary trust. As helpful as such statements might appear to be, however, they are rarely done in connection with the typical

discretionary trust. In addition, most such trusts either say nothing about what the trustee should consider in exercising its discretion, or contain the typical "ascertainable standard" (for example, that the trustee may make distributions for a beneficiary's "health, education, maintenance, and support"). This approach, while helpful for income and/or estate tax purposes,[4] tells the trustee little if anything about the settlor's actual wishes and gives the trustee extremely broad discretion to determine what falls under those categories. And occasionally, trusts will contain more liberal standards, such as "comfort," or "happiness." When these "standards" are accompanied (as they typically are by habit or custom, if nothing else) by words modifying (i.e., enlarging) the trustee's discretion, such as "sole," "absolute,", "unfettered," or "uncontrolled" (discretion), the presence of a standard becomes almost moot. This is because those words modifying the trustee's discretion allow the trustee to act unreasonably when exercising its discretion, so long as he does not act in bad faith, for an improper purpose, or with an improper motive.[5]

Accordingly, when we establish a trust giving the trustee broad discretionary powers (with or without a standard) and nothing more, we are basically saying to the trustee, "Do whatever **you** think is appropriate, without regard to what I might do in the same situation, being guided of course by so-called fiduciary standards." Is this what clients really want? Are we as advisors overlooking a vital issue in drafting the trust? Shouldn't we at least review this issue with clients and give them the opportunity to write a letter of wishes?[6] Or will the existence of such a letter cause more problems than it may solve, especially if the beneficiary gets a look at it? And if a letter does exist, do the beneficiaries have a right to look at it?

In an excellent treatise[7] on the subject of exercise of discretion by trustees, Professor Edward C. Halbach, Jr. points out that "too frequently the trust instruments provide no guidance as to the purpose and scope of the power. [The trustee] should be informed of the purposes of the trust, the factors he is to consider, and something of the general frame of mind in which the settlor wishes him to act."[8] Professor Halbach also observes that the general failure of attorneys to develop and provide such information "is one of the most neglected aspects of estate planning."[9] And yet, interestingly, he doesn't hint at the idea of anything equivalent to a letter of wishes.

Unfortunately, Professor Halbach is not alone. For reasons I am at a loss to discover or understand, there is absolutely no mention of, reference to, or information on letters of wishes (to a trustee) in any of the trust treatises, reference works, reported cases, or legal encyclopedias. Further, I could find no articles on the subject in any of the recognized (U.S.) professional legal journals or magazines. There are, on the other hand, a fair but by no means overwhelming amount of reference material and cases on the subject in the United Kingdom and jurisdictions that follow English Law.[10] The problem is that almost without exception these materials and cases address only the issue of whether the beneficiaries have the right to see non-binding letters of wishes, rather than how useful and effective they may be from a practical standpoint in effectuating a settlor's wishes in the administration of her trust. Perhaps this is because if the letter is not binding on the trustee, of what value would it be to a court in addressing a beneficiary's complaint that the trustee abused its discretion?[11]

It is well-settled law that a court will not interfere or second-guess a trustee's exercise of discretion, unless there is bad faith or an improper motive.[12] But according to the leading American treatise on trust law, "The real question is whether it appears that the trustee is acting in that state of mind in which it was contemplated by the settlor that he would act."[13] How would we know what the settlor contemplated if all we have to work with are broad discretionary powers and broad standards expressed in language that is not even the settlor's? The obvious answer is a settlor's letter of wishes. But if the settlor intends the letter to be confidential how does that help a beneficiary unsuccessfully seeking from the trustee, for instance, funds to open a gallery to display his paintings or to study Italian for six months at the University of Perugia? One would hope that trustees in possession of a letter of wishes which clearly contemplated distributions for such items would be morally bound to comply, at the least. But if they did comply and were later criticized or formally charged by another beneficiary for making excessive distributions, could the non-binding letter serve as a defense? It probably would, if a defense in fact was necessary, but again, this begs the question of disclosure. That is, does a beneficiary, or a court, have the right to force the trustee to disclose such a letter?

The Restatement Second of Trusts, the recognized authority in American Trust law, at section 173 states:

> "The trustee is under a duty to the beneficiary to give him upon his request at reasonable times complete and accurate information as to the nature and amount of the trust property, and to permit him or a person duly authorized by him to inspect the subject matter of the trust and the accounts and vouchers and *OTHER DOCUMENTS* relating to the trust." (Emphasis added)

The obvious question for our purposes is what are *other documents*, and why were the drafters of the Restatement so vague on this point? Would "other documents" include confidential non-binding letters of wishes? Or private correspondence between trustees regarding the exercise of discretion? Comments to this section of the Restatement shed no light whatever on what might be included, or excluded, in "other documents". Certainly there is no question that beneficiaries are entitled to see all documents relating to the trust corpus, such as investment account statements and records of transactions, as well as contracts, leases, legal opinions, and correspondence relating to administration of the trust (other than those between attorney and trustee relating to trustee duties and liabilities). But what else?

Unfortunately, there does not appear to be a single reported U.S. case interpreting the meaning of trust "documents". At least one English case, however, addressed the issue in connection with what must be disclosed to beneficiaries.[14] In that case, the court observed two basic principles (not necessarily consistent with one another) that must be considered. First, that "trustees exercising a discretionary power are not bound to disclose to their beneficiaries the reasons actuating them in coming to a decision." Second, a beneficiary is generally entitled to inspect "all documents relating to the affairs of the trust." Note, however, that this was a proceeding against the trustees involving rules of discovery, and the action was based in part on the trustees' refusal to produce certain "documents." Overturning a lower court's ruling that all "trust documents" were the property of beneficiaries and therefore the beneficiaries had a proprietary right in them, the court declined to order the trustees to produce certain of the documents, including minutes of trustees' meetings which might disclose the reasons behind their exercise of discretion. The court also noted, however, that this privilege would be overridden in "an action impugning the trustee's good faith."

A later landmark case on the issue, based on English law but decided in Jersey, was Re Rabaiotti's 1989 Settlement.[15] Among other things, that case dealt with whether a beneficiary should be entitled to see a non-binding letter of wishes written to the trustee. There, the court concluded that:

(a) a beneficiary is not normally entitled to see a (non-binding) letter of wishes.
(b) this was because: -
  (i) it fell within that category of documents which would or might disclose the reasons for the exercise of a discretionary power (see Re Londonderry[16]); and
  (ii) because it was a document which was confidential to the trustees.[17]

Nevertheless, because of specific and extenuating facts of the case, including the fact that previous letters of wishes were already disclosed to one of the parties, the court exercised its discretion to order disclosure of the non-binding letter of wishes.

Still another case holding that letters of wishes are not "trust documents" and therefore not disclosable to the beneficiaries without a court order is Hartigan Nominees Pty Limited, decided in Australia.[18] In that case the Royal Court held that the (non-binding) letter of wishes was not a trust document, that it was given to the trustees in confidence, and that it related to the reasons for the exercise of a trustee's discretion and was therefore non-disclosable based on the rule in Londonderry[19], an earlier English case. Thus, the common law rule, offshore at least, appears to be that non-binding letters of wishes to the trustee are generally not disclosable to the beneficiaries, but in certain cases they may be subject to the rules of discovery, especially if it appears that the trustee acted in bad faith or for an improper purpose. In deciding whether to order disclosure, the court typically will review the letter privately to determine if disclosure would be in the best interests of the parties and serve the purposes of the trust.

There is one U.S. case dealing with the issue of discovery of trust "books and records," but it is neither helpful nor insightful as to letters of wishes. *Union Trust Company of San Diego*[20]

involved the issue of whether a trustee could refuse to allow a beneficiary (or settlor) of a trust to inspect the books and records of the trust. Throughout the case report it is apparent that it was the "usual" books and records (such as details and records of financial transactions) that were sought to be inspected, as opposed to items such as letters of wishes or minutes of trustee meetings relating to the exercise of discretion. Nevertheless, the opinion, which favored the beneficiary's right to inspect the books and records, repeatedly employed broad, unspecific phrases such as "books and documents," and "books, papers, writings, vouchers, and other documents," indicating either that the court simply never contemplated the existence of a document that may be privileged to the trustees alone or that may not be in the best interests of the beneficiaries to disclose.

Whether a settlor's non-binding letter of wishes ought to be disclosed or available to a beneficiary may also depend on the contents of the letter. If seen by a beneficiary, the hypothetical letter at the beginning of this discussion might serve to encourage the beneficiary to request more funds from the trustee for any or even all of the examples given, but remember the letter is not binding on the trustee, and so there is no obligation to comply with the beneficiary's request. The letter is merely to apprise the trustee of the settlor's wishes (and "state of mind") as to how the trustee's discretion may be exercised. Our hypothetical letter makes it clear that the settlor wishes (rather than directs) the trustee to be liberal with the distributions and not preserve principal "at all costs" for the remaindermen, to the detriment of current beneficiaries. And if the trustees did refuse a beneficiary's request, say, for funds to start a business, the existence and disclosure of the settlor's letter would not necessarily be grounds for a beneficiary's complaint. Again, the purpose of the letter is to apprise the trustees how the settlor may have decided in a similar situation and not to obligate them to so act. They may consider the settlor's wishes and may even feel morally bound to act in accordance with them, but they need not do so. Their own discretion is the last word.

It should also be noted, and a number of (offshore) court opinions have observed, that some letters of wishes may contain information that would be hurtful to the beneficiaries and in their best interests should not be disclosed. For instance, consider the following language inserted in a letter of wishes to the trustees:

> “Where distributions are to be made to my son, keep in mind that although he is a fine person, he has demonstrated bad judgment, is of weak character, and could easily be adversely influenced by outside sources. I prefer that you place as little funds as possible under his direct control. Also keep in mind that my daughter, who has never been gainfully employed and has been married three times, has obvious difficulty with responsibility and relationships. Accordingly, you should keep “strings attached” to all distributions made to her.”

Obviously, disclosure of these statements to the beneficiaries would serve no purpose whatever and would be embarrassing and hurtful to the settlor’s children. Yet they may be helpful to the trustees in exercising their discretion.

Recommendations.

Drafting attorneys habitually draft discretionary trusts offering no real guidance whatever to the trustees in the exercise of their discretion with respect to distributions to beneficiaries. Despite the obvious shortcomings of this approach and the casual treatment of this critical element of a trust, we continue to perpetuate it. This is wrong. We should strongly encourage settlors to provide a non-binding written expression of the manner in which they would like to see the trustees exercise their discretion, so that the administration of their trusts will have a good chance of reflecting the manner in which the settlor herself would have administered it. At the same time, we should caution the settlor not to include in the letter derogatory or inflammatory comments on the character or behavior of the beneficiaries so as to avoid embarrassing or hurtful results if the letter was disclosed. If the settlor felt compelled to comment on the beneficiary’s character, it could be done in a separate confidential letter to the trustee, which would most likely not be the subject of a court-ordered disclosure, as that would serve no purpose. Although there is no law or authoritative commentary in the United States relating to the beneficiary’s right to see documents relating to the trustee’s exercise of discretion, a carefully drafted non-binding letter of wishes given to the trustee, possibly with a copy to the beneficiary, will enlighten all parties as to the manner in which the settlor contemplated her trust would be administered.

Copyright © 2006 by Alexander A. Bove, Jr. All rights reserved.

---

[1] Proper reference should be made to identify the trust.

[2] As suggested at the end of the discussion, depending on the contents of the letter of wishes, it may be acceptable for the beneficiaries to have a copy, in which case this sentence would be deleted.

[3] For American law, there is no commentary on the subject of letters of wishes. For a brief but excellent discussion of English law regarding letters of wishes, see Hayton and Marshall, *Commentary and Cases on The Law of Trusts and Equitable Remedies*, Para. 9-215 – 9-240 (11th Edition, Sweet & Maxwell 2001) (hereafter "Hayton & Marshall").

[4] See e.g., Internal Revenue Code (IRC) Sections 674, 2038, 2041.

[5] Austin Wakeman Scott and William Franklin Fratcher, *The Law of Trusts*, Section 187.2 (4th ed. Little Brown & Co. 1987) (hereafter "Scott & Fratcher").

[6] It should be noted that in many cases, close family members themselves may be the trustees who are to exercise discretion, and they are usually well aware of the settlor's wishes. While this may be so, it is also very risky. If the family member in question is the settlor's spouse, I would agree that the spouse trustee would likely have insight as to the settlor's frame of mind. But as we get further beyond that, questions can arise. And on many occasions, an "independent" trustee is either necessary (for tax purposes) or advisable (for objective judgment purposes). In those cases, we are back to the helpfulness of a letter of wishes.

[7] Halbach, Jr., Edward C., *Problems of Discretion in Discretionary Trusts*, Col. L. Rev. Vol. 61, p. 1425 (1961) (hereinafter "Halbach").

[8] Id at p. 1433-1434.

[9] Id at p. 1434.

[10] See, e.g., Hayton & Marshall, *supra* note 2; *Re Londonderry's Settlement* (1965) Ch 918 (England); *Re Rabaiotti's 1989 Settlement* (Judgment Number 2000/090) Royal Court of Jersey (unreported).

[11] If the letter of wishes is written to be binding on the trustee, it becomes a part of the trust and will be accessible to the beneficiaries as a matter of law. See *Restatement Second Trusts* section 173.

[12] Scott & Fratcher, *supra* note 5 at section 187; and Halbach, *supra* note 7 at pp 1430-1433.

[13] Id.

[14] *Re Londonderry's Settlement*, *supra* note 10.

[15] *Re Rabaiotti's Settlement*, *supra,* note 10.

[16] *Supra*, note 10.

[17] Benest, David J., *Re Rabaiotti Revisited: Are Letters of Wishes Disclosable*? Trusts & Trustees, February 2001.

[18] Hartigan Nominees Pty Limited v. Rydge, 29 NSlr 405.

[19] *Supra*, note 10.

[20] *Union Trust Company of San Diego v. Superior Court In and For San Diego County, et. al*., 118 A.L.R. 259 (1938).