Digital-Age Record Retention Practices for Trusts

Proper file maintenance is a fiduciary duty that can extend over a prolonged period when trusts are involved.

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The expansion of electronically stored information (ESI) has radically changed the landscape for both business and business litigation. Everyday commerce now creates a massive wake of electronic records that can be expensive and unwieldy to maintain over time, despite rapid advances in storage and search technologies. At a time when 500-page documents can be transmitted instantly to dozens of recipients and entire deals can be negotiated over e-mail, businesses have to think about recordkeeping, confidentiality, regulatory compliance, and civil liability in a whole new way.

As ESI recordkeeping enters its adolescence, trust administration occupies a special niche and presents distinct challenges, particularly to institutional trustees. Trustees owe specific duties with respect to recordkeeping that are materially different from other regulatory recordkeeping duties imposed on various industries. Moreover, trust administration (particularly for private, noncharitable trusts) can unfold over an unusually lengthy time horizon during which the specter of liability exists well beyond most civil limitations periods. This article discusses Pennsylvania law, but the precepts are common to most states.

Records retention policies generally

Non-profit and for-profit entities alike focus their records retention on two key areas: internal needs and external compliance. Internal needs involve an assessment of what records are necessary to properly perform the entity's activities, how long each category of records reasonably needs to be retained, and the costs and burdens of retention. External compliance involves local, state, and federal laws and regulations regarding records retention and may also involve the rules or recommended guidelines of trade groups.

For entities of any size or complexity, these assessments tend to result in the development of a records retention policy that sets forth categories of records with methods and durations of retention. For example, copies of tax returns and their underlying documentation are kept for the limitations period for IRS investigation; contracts may be kept until performance is complete, plus sufficient time to run the limitations period on a contract action; and wage and hour records are kept for the time required by federal law.

Commonplace electronic communications or paper records may be purged on set schedules to reduce storage costs and other burdens. Such retention policies typically include special, separate procedures for a "litigation hold" of relevant materials when the entity

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is notified of pending or likely legal disputes.

As long as its retention policy is reasonable (and does not run afoul of applicable laws or regulations), the entity is usually protected from later assertions that it "destroyed evidence" necessary for legal proceedings. For example, in *Mead v. Travelers Indemnity* Co.,[1] an insured sought sanctions against its insurer in a coverage dispute for failure to produce in discovery a copy of a policy cancellation notice. Travelers explained that it destroyed its copy of the notice in question "pursuant to its document retention policy 90 days after it was generated ... [which] was four days after plaintiffs filed their claim" for coverage. The district court concluded that there was no spoliation because Travelers had acted reasonably and in good faith in implementing its retention policy.

Trust record difference

From the outside, many contemporary trusts resemble personal investment accounts in that they can consist, in large part, of a portfolio of securities and a ledger of income, expenses, and distributions. In addition to the obligations expected of an asset custodian or investment manager, however, the trustee of a trust bears other affirmative duties that can sustain for many years. Therefore, the process of retaining records, including ESI, must be approached differently. In addition, trustee liability is not restricted by clear limitations periods. In some instances, an aggrieved beneficiary can look back decades for potential harm to the trust. Because of this, good recordkeeping can be essential to establishing proper trustee conduct.

Reporting duties owed by trustees. Under the Pennsylvania Uniform Trust Act (UTA), trustees owe an affirmative statutory duty to "keep adequate records of the administration of the trust."[2] This duty is considered central to a trustee's overarching duty to act with prudence in the management of the trust.[3] In addition, a trustee is obligated to "promptly respond to a reasonable request by the settlor of a trust or by a beneficiary of an irrevocable trust for information related to the trust's administration."[4] Now codified in statute, these duties arise from longstanding common law.[5]

Neither of these duties (to keep adequate records and to timely report) is circumscribed by an express limitations period. Further, beneficiaries are entitled to prompt reporting on trust inquiries irrespective of whether any conflict exists between them and the trustee.[6] In other words, beneficiaries can obtain documents and information outside of discovery connected to active litigation.

These trustee obligations feed into the duty to account for the administration of the trust.[7] Such accounts need to show "in detail the nature and amount of the trust property and the administration thereof."[8] While trust accounts do not require the trustee to hand over every scrap of paper in the files, the requirement to present a detailed and complete report obviously demands maintenance of documentation (nowadays often in electronic form) for the period of the account.

Trust records do more than just "prove up" specific transactions. Trust records also illustrate a trustee's process in administering a trust.

Beneficiaries have the right to lodge objections to an account.[9] Such objections can concern any line item in an account or any aspect of trust administration during the accounting period. And while the question of burdens of proof in objections is complex, Pennsylvania courts are clear that trustees bear the burden of validating any expenses questioned by beneficiaries.[10] Book entries or trustee testimony alone are usually considered inadequate proof to substantiate such expenses. In other words, trustees have to "keep their receipts" or risk reimbursing the trust.

Unless otherwise specified in the trust instrument, trust accounts are not filed on a regular basis.[11] Thus, a trustee must be prepared to substantiate actions taken many years prior to the filing of an account.

While the requirement to keep complete records has not changed, the advent of ESI means that trustees have to be vigilant about when and where records arise. For example, a trustee might hire an investment advisor in year one of a trust's administration, paying commissions

1 71 F. Supp. 3d 516 (DC Pa. 2014).

2 20 Pa. C.S. § 7780(a).

3 *Id.*, Unif. L. Comment.

4 20 Pa. C.S. § 7780.3.

5 See Estate of Rosenblum, 328 A.2d 158 (Pa. 1974).

6 *Id.*

7 See 20 Pa. C.S. § 7797.

8 Restatement (Second) of Trusts § 172, Comment a. See also Pa. O.C. Rule 2.1 (2016) (setting forth the requirements for a fiduciary account).

9 20 Pa. C.S. § 7798(a); Pa. O.C. Rule 6.10 (2016).

10 See McColligan Estate, 26 Fid. Rep. 2d 299 (O.C. Phila. 2003) (discussing Strickler Estate, 47 Pa. 134 (Pa. 1946), and other cases).

11 See 20 Pa. C.S. § 7797(a) (accounts filed when ordered by the court or at the discretion of trustee). It is not unusual for the period of a trust accounting to span many years, even decades. See, e.g., Estate of Tyler, 289 A.2d 441 (Pa. 1972) (discussing filing of first account in 1967 of a trust made irrevocable in 1932).

to that advisor based on an emailed fee agreement. If the trustee files an account ten years (and perhaps two investment advisors) later, but cannot locate the fee agreement email, the trustee risks a surcharge for the commissions paid. The email could have been left behind in an abandoned email account or purged as part of an established corporate email reduction policy.

Good records are proof of prudent "process." Trust records do more than just "prove up" specific transactions. Trust records also illustrate a trustee's process in administering a trust. Records of this process can be crucial to staving off liability, particularly concerning investments and other actions dependent on trustee discretion.

Trustees are subject to a variety of fiduciary duties.[12] Trustees are obligated to administer the trust "in good faith, in accordance with its provisions and purposes and the interests of the beneficiaries and in accordance with applicable law."[13] Administration must be "prudent" which, at a minimum, requires a trustee to consider "the purposes, provisions, distributional requirements and other circumstances of the trust[.]"[14]

In Pennsylvania, as in most states, trusts assets must be invested in accordance with the "prudent investor rule" which requires a trustee to act as a prudent investor would after taking various facts and considerations into account.[15] Importantly, the court in *McFadden Trusts*, [16] stated that "in evaluating a fiduciary's management of [trust investments], the prudent investor rule focuses on 'standards of conduct not of outcome and performance.'" Where trustees "adhere to a thoughtful, prudent process in deciding on the allocations and investment scheme" of a trust, they likely have discharged their duty, even where the trust sustains losses.

Thus, records of a trustee's "process" can be crucial to establishing that the trustee was prudent. *McFadden Trusts* is very useful illustration of this. Challenged for maintaining a risky investment portfolio after an unexpected change in beneficiaries and the advent of dropping markets, the trustees of these trusts avoided liability by propounding evidence that they had communicated regularly, considered the change in beneficiaries and the market volatility, and made and adjusted their decisions accordingly.[17] The very complete record of the trustees' process convinced the Orphans' Court that they had acted prudently, even though on the surface it appeared as if they had not "acted" at all by maintaining investments as-is during a period of great change.

By contrast, the lack of records of such a process can undermine a trustee's legal defenses. In a New York dispute, *In re J.P. Morgan Chase Bank*, [18] J.P. Morgan was surcharged for failing to timely diversify a group of trusts originally funded with Eastman Kodak stock. The corporate trustee argued that it retained the Kodak stock for so long because the income beneficiary wanted it to. The Surrogate's Court rejected that defense because "the Trustee supplied no evidence of any instrument, letter, or even record of a telephone conversation in which this preference for Kodak stock was communicated." In addition, the court sharply criticized the corporate trustee for recording a need to diversify one of the trusts and "without further documented discussion of a diversification plan, all of the Kodak stock was suddenly sold[.]" In other words, even where the trustee took decisive action, the court found fault because no records explained the action or its timing.

Certainly, a complete set of ESI records will not spare a trustee from a court finding of breach of trust where the court deems the trustee's conduct imprudent. But the lessons of *McFadden* and *J.P. Morgan* are that any defense or mitigation will require evidence of planning, analysis, and deliberations underlying fiduciary decisions (even decisions to take no action). Process is a big part of prudence.

New view of the trust record retention

The role of trustee exceeds the mere provision of services and products. It truly is a relationship—with the beneficiaries, of course, but also with the trust itself and its creator. Whether the trustee is an individual, a financial or accounting institution, or a law firm, the expectations are higher both legally and otherwise because of the unique nature of this fiduciary position. The trustee must adjust its operations to the requirements of the role, not the other way around.

As discussed above, records retention is central to the trustee role. In many instances, an existing records retention policy used effectively by a person for non-trustee business will be inadequate for trust records. The ruling in

12 See, e.g., 20 Pa. C.S. § § 7771 through 7780.3 (setting forth various statutory duties required of trustees in Pennsylvania).

13 20 Pa. C.S. § 7771.

14 20 Pa. C.S. § 7773.

15 20 Pa. C.S. § 7203. All existing Pennsylvania trusts are subject to the prudent investor rule, but trusts that became irrevocable prior to 12/25/1999 are not subject to the "diversification" requirements set forth at 20 Pa. C.S. § 7204.

16 2 Fid. Rep. 3d 41 (O.C. Phila. 2011) (quoting 20 Pa. C.S. § 7213).

17 2 Fid. Rep. 3d at 76-79 ("the record demonstrates that throughout this critical period, the two trustees actively reviewed the portfolios and considered various investment options [and the market crisis] rendered any dramatic change in the portfolio imprudent until the markets stabilized").

18 41 Misc.3d 1231(A) (N.Y. Surr. 2013).

Mead v. Travelers Indemnity Co.[19] would not play out the same way in the trust context where even a "reasonable" records policy can fall far short of the legal duties expected of trustees.

Aggressive approach to records retention. Pennsylvania does offer trustees a limited avenue to circumscribe both recordkeeping and liability, but it is "untested" at this time. What follows is a summary of this route and reasons why trustees should avoid this as the basis for an aggressive approach to records-related duties.

UTA section 7785 bars a beneficiary "from challenging a transaction or asserting a claim against a trustee for breach of trust" where certain conditions are met.[20] First, the trustee must provide "periodic written financial reports" on the trust at least annually. Second, any such reports must contain a "conspicuous written statement" that beneficiaries' rights to make claims regarding any transactions in the report will be subject to a 30-month limitations period.

UTA section 7785 does not, however, mean that trustees can send regular trust reports containing a statement of a limitations period and then just wipe the record 30 months later. The provision does not relieve a trustee of the duties discussed above to provide information or prepare an account if ordered by a court. While the provision may limit the right of action of a beneficiary—a very powerful shield—it does not limit another trustee from bringing claims or a court from imposing a surcharge for imprudent administration of a trust.

Further, at this time, there are no published decisions analyzing section 7785, so its scope and effectiveness are wholly untested. Notice of a particular transaction in a trust report does not necessarily alert a beneficiary of a potential claim. For example, a trustee could be investing in a manner that appears facially reasonable, but still be committing a breach of trust by doing so without considering all the necessary factors under the prudent investor rule.

In *Estate of Scharlach*,[21] the fiduciary invested a guardianship estate in step with the provisions of a court order. The fiduciary was later surcharged, however, for failing to seek leave to invest outside of that order after an independent advisor hired by the fiduciary concluded that a new plan was necessary to meet the needs of the incapacitated person. If a fiduciary can be surcharged even when investing in alignment with a court order, it is difficult to envision a trustee spared surcharge for merely sending out periodic statements with section 7785 language on them.

In short, trustees can make use of UTA section 7785 to limit liability in some instances, but it is not appropriate for limiting the duties to maintain trust records including ESI.

Custodial approach. Instead of applying standard records retention policies to trusts, trustees should instead prepare trust-specific recordkeeping practices. While this may involve additional burden and expense, these are part-and-parcel of accepting the obligations of trusteeship and protecting against liability.

At a minimum, records that are material to trustee decisions or that illustrate key areas of trust administration should be kept through any accounting period—i.e., any period from the creation of a trust or end of a prior account through the filing of a new account. Once a trust account is adjudicated, all persons are barred from bringing new claims regarding trust administration for that accounting period.[22] Indeed, in a trust where the trustee expects objections to its administration, or even just where trust administration is unusual or complex, it might behoove the trustee to file accounts on a regular basis to ensure that files can be thinned and any potential liability is addressed.[23]

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What exactly to keep in a trust file will be dependent on the trust, the trustee, and the methods of communicating and making decisions. E-mail can pose a particularly thorny problem in this regard. E-mail is used for everything from planning a friendly lunch gathering where no business will be discussed to debating the merits of various trust investment plans. On the one hand, capturing and keeping all emails would retain a lot of ephemera, perhaps unnecessarily. Purging all emails, on the other hand, would strip trust files of valuable, contemporaneous records that in many instances are the very best evidence of "process."

ESI, and email records in particular, raise unique challenges in large financial institutions where

[19] Note 1, *supra*.

[20] 20 Pa. C.S. § 7785(a).

[21] 809 A.2d 376 (Pa. Super. 2002).

[22] 20 Pa. C.S. § 7798.

[23] *Cf.* Hirt Trust, 98 Erie L.J. 46 (O.C. Erie 2015) (trustee filed a second accounting in a six-year period of trusteeship of a trust that involves unusual duties and is known for contention and litigation).

dozens of individuals may participate in a trust administration. There could be account opening personnel, trust officers and their supervisors (who can change over the years), fiduciary committees that review and decide as a group on discretionary trustee actions, accounting staff, tax specialists, legal counsel, and so on, all communicating about and creating ESI regarding a trust. Decades of mergers and acquisitions of smaller banks into huge, multinational financial services corporations can both (1) grow these already large pools of people exponentially regarding each trust account; and (2) create risks that data will be lost, overlooked or purged as the institution evolves.

The question of what to keep also leads quickly to the question of how to keep ESI. This question is particularly important for "institutional" trustees like banks or professional firms that might have existing document retention (and purging) policies. Printing out all material ESI records to create "hard copies" that can be placed in a physical file is an option, but one that may miss some valuable data like voicemail messages or database information.

Keeping all records in paper form also could be costly and burdensome in terms of storage. Establishing segregated ESI storage for trust files or modifying an existing corporate records retention policy to create a category for trust records are just two options regarding retention of trust ESI in electronic form. And it may be that a hybrid approach—some paper printouts and some electronic storage—would be most efficient and effective for both administrative and record-keeping purposes. Obviously, any approach will also require personnel training and monitoring.

In short, a trustee needs to approach ESI records retention with two key values in mind. First, the trustee should view the process of recordkeeping as custodial in nature—a duty to keep the history of the trust so that the trustees, the beneficiaries, the court, and any other stakeholders can be fully informed. Second, the trustee needs to plan for recordkeeping with the same kind of care and prudence that the trustee might apply to investments, beneficiary distributions, tax preparation, and other trust administration matters. Recordkeeping cannot be an afterthought.

Although specific planning will vary by trust and trustee, the following questions provide a starting point:

1. Where is trust ESI found?
2. What are the criteria for deeming ESI a "material" trust record?
3. Who receives or creates material trust records?
4. Who will be responsible for retaining material trust records?
5. How should material trust records be maintained?
6. What changes need to be made to existing ESI policies to ensure that material trust records are effectively maintained?
7. How will compliance checks be implemented?

Conclusion

Trustees must accept that proper maintenance of a trust "file" is not a theoretical or academic issue. Instead, it reflects a bundle of fiduciary duties that affect trust administration and could serve as an overlooked vector for liability. Trustees need to plan their "filekeeping," particularly the collection and maintenance of ESI, as carefully as they plan the other actions they take in discharging their duties to beneficiaries. ■