TRUST LITIGATION IN TEXAS

FRANK N. IKARD JR., *Austin*
Ikard & Golden

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CHAPTER 7.1

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1 DEFINITIONS:

1.1 "**Beneficiar**y" refers to any person for whose benefit property is held in trust regardless of the interest. The beneficiaries of a trust hold beneficial title to the trust estate of a trust. The term may refer to a present beneficiary or a remainder beneficiary or to a beneficiary who's interest is either vested or contingent.

1.2 "**Corpus**" refers to the property (other than income) comprising the trust estate of the trust. This term is synonymous with the term "Principal". Corpus is more particularly defined in Texas Trust Code §116.002(10). This term may also apply to a person who, after the creation of a trust, contributes property to the trust estate of the trust.

1.3 **"Fiduciary"** refers to the trustee of a trust and shall refer to the equitable relationship between the trustee and the beneficiaries of the trust.

1.4 **"Fiduciary Duties"** refers to the equitable duties imposed upon a trustee by either the instrument creating the trust, by the Texas Trust Code or by the common law.

1.5 **"Grantor"** refers to a person who creates a trust. This term is synonymous with the term "Trustor" or "Settlor". This term may also apply to a person who, after the creation of a trust, contributes property to the trust estate of the trust.

1.6 **"Income"** refers to the income or yield from the investment of the trust estate of a trust. Income is more particularly defined in Texas Trust Code §116.002(4)

1.7 "**Income Beneficiary**" refers to the person who is currently has a right to receive income form the trust estate of the trust.

1.8 **"Net Income"** refers to the income of a trust that remains after the allocation of the debts, taxes and administrative expenses that are allocated to income pursuant to the terms of the trust instrument or Texas Trust Code §116.002(8).

1.9 **"Remainder Beneficiary"** refers to the person who receives the trust estate of the trust upon the termination of the trust.

1.10 **"Settlor"** refers to a person who creates a trust. This term is synonymous with the term "Trustor" or "Grantor".

1.11 "**Trustee**" refers to a person or firm that is administering the trust estate of a trust. The trustee holds legal title to the trust estate of the trust.

1.12 "**Trust Estate**" refers to the property being administered by the trustee of a trust.

1.13 **"Trustor"** refers to a person who creates a trust. This term is synonymous with the term "Settlor" or "Grantor".This term may also apply to a person who, after the creation of a trust, contributes property to the trust estate of the trust.

2 INTRODUCTION:

2.1 **SCOPE OF PAPER:** This paper does not purport to deal with non-fiduciary litigation issues, it deals primarily with special considerations that are incident to trust litigation in Texas.

This paper does deal with causes of action involving the construction, administration or distribution of a trust brought by either a beneficiary of a trust or a trustee of a trust. It does not deal with causes of action brought by third persons who are not beneficiaries of a trust.

While numerous general treatises on trust law are cited in this paper, this paper deals exclusively with trust litigation in the State of Texas.

2.2 **A TRUSTEE IS A FIDUCIARY:** A trustee, once he has accepted appointment, becomes a fiduciary for the beneficiaries of the trust. See A. Scott & W. Fratcher, *The Law Of Trusts*, §170, Bogert, *Trusts and Trustees* (Second Edition Revised), § 150, American Law Institute, *Restatement (Second) of Trusts, §2 (1980).* See Also *Texas Bank and Trust Company v. Moore*, 595 S.W.2d 502 (Tex. 1980) (The court in this case recognized that a trustee is a "fiduciary")

2.3 **A TRUSTEE IS SUBJECT TO FIDUCIARY DUTIES:** Trustees are subject to the duties imposed by common law, the duties imposed by the Texas Trust Code and the duties imposed by the instrument creating the trust. Tex. Trust Code §113.051.

2.4 **THE TEXAS TRUST ACT IS A CODE:** The Texas Property Code (which contains the Texas Trust Code) is "a code enacted by the 60th or a subsequent legislature as a part of the state's continuing statutory revision program." Texas Code Construction Act, Tex. Government Code §311.002 (1). Consequently the interpretation of the Texas Trust Code is governed by applicable provisions of the Code Construction Act.

3 EQUITY:

3.1 EQUITABLE CAUSES OF ACTION: The causes of action dealt with in this paper are almost always equitable (rather than legal) causes of action. Notwithstanding misclassification by many Texas courts[1], most causes of action involving trust litigation are actions in equity rather than (tort or contract) actions in law.

3.1.1 The Distinction Between Legal and Equitable Proceedings: The legal system in ancient England evolved into a system of very rigid laws with a strict observance of arbitrary and technical forms. To remedy the inflexibility and inequity that existed in courts of "law" a new legal system evolved that allowed controversies to be resolved in courts of "equity" which were governed by the crown and/or by the church. Courts of equity rejected the arbitrary and technical form practice that prevailed in courts of law.

Bogert, *Trusts and Trustees* (Second Edition Revised) at §870 explains this distinction as follows:

> The court of equity first recognized the trust as a legal institution and has fostered and developed it. The beneficiary naturally goes to this court for protection of his rights under the trust....
>
> Although great changes have taken place with respect to law and equity, and in most states there are now no separate courts administering equity jurisprudence and the same court of general jurisdiction enforces legal and equitable rights, it is nevertheless important to recall that the beneficiary's remedies are equitable principles. ...
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> A suit for equitable relief is applicable where the trust remains in existence and the suit is for the statement of an account and the recovery of an

[1] See, for example, *Interfirst Bank Dallas, N.A. v. Risser,*739 S.W.2d 882 (Tex. App. - Texarkana 1987): "However, an intentional breach of fiduciary duty is a tort justifying the award of exemplary damages." (emphasis supplied)

> unliquidated sum. Equity has generally been held to have exclusive jurisdiction to assist the beneficiary where the basis of the suit is the negligence of the trustee in managing the trust property, or the wrongful conveyance of the trust property to another, or a breach of trust in neglecting to collect and apply the trust assets according to the trust terms, or damage to the trust property by the trustee which would be waste if committed by a tenant, or where the possession of trust realty or personalty or the value of the trust property wrongfully sold is sought by the beneficiary, or where the object is an account of rents and profits of land held in trust, or where the basis for suit is the conversion by the trustee of trust property or its proceeds.

Fratcher, *Scott on Trusts* (Fourth Edition) provide at §198 that:

> Although the remedies of the beneficiary against the trustee are ordinarily exclusively by a proceeding in equity, there are certain situations in which a remedy at law has been permitted. In these situations the liability of the trustee is definite and clear and no accounting is necessary to establish it. The first situation includes cases where the trustee is under an immediate and unconditional duty to pay money to the beneficiary. The second situation includes cases in which the trustee is under a duty immediately and unconditionally to transfer chattel to the beneficiary. In other situations it is held by the weight of authority that the remedies of the beneficiary are exclusively equitable. As we have seen, the trustee is not liable in an action at law for breach of contract for his failure to perform his duties under the trust. We have also seen that where it is the duty of the trustee to convey land to the beneficiary, the beneficiary can enforce the duty only by a proceeding in equity, and cannot maintain an action of ejectment or other action at law, since the title to the land is in the trustee and the beneficiary has only an equitable interest in it. Similarly, in the case of other property, such as chattels and securities, the remedy against the trustee for breach of trust is ordinarily in equity and not at law.

3.1.2 **The Historical Effect Of This Distinction:** There are two practical differences between courts of law and courts of equity that have evolved into modern jurisprudence. First, courts of equity do not usually utilize jury trials. Second, courts of equity may impose any remedy necessary to right the wrong - they were not constrained by the less flexible remedies imposed by courts of law.

3.1.3 **Texas Courts:** In Texas, courts of law and equity are combined into the same court.

3.1.4 **Right To A Jury In Equitable Proceedings in Texas:** In many states the right to trial by jury is not available in trust litigation. This is not the case in Texas. In Texas, a jury resolves issues of fact in equitable proceedings. The fashioning of an appropriate equitable remedy remains, however, exclusively within the providence of the court.

Two provisions of the Texas Constitution insure the right to a jury trial in Texas. Tex. Const. art. I §15 and art. V, §10.

The court in *Casa El Sol-Acapulco, S.A. v. Fontenot,* 919 S.W.2d 709, 715 (Tex. App. - Houston[14th Dist.] 1996, writ dism'd by agreement) analyzed these constitutional provisions and concluded that:

> There is no common-law right to a jury trial in equity. *Trapenell v. Sysco Food Services, Inc.,* 850 S.W.2d 529, 543 (Tex. App. - Corpus Christi 1992, aff'd 890 S.W.2d 796 (Tex. 1994). However two provisions of the constitution insure the right to a jury trial in Texas. The first is contained in the Texas Bill of Rights. See Const. art. I §15. This provision guarantees

> "the right to a jury trial in all actions where that right existed at the time of the Constitution was adopted." *State v. Credit Bureau of Laredo, Inc.*, 530 S.W.2d 288, 291 (Tex. 1975). Because the English chancery were judges of both fact and law at the time our constitution was enacted, this provision does not alter the common law tradition eschewing juries in equity actions.
>
> Because of Texans' familiarity with Spanish law and procedure, they adopted a second constitutional provision insuring the right to a jury trial in all causes. This provision is found in the Judiciary Article. See Tex. Const. art V, §10. Thus in Texas, the "traditional distinctions between actions at law and suits in equity have never carried the procedural significance accorded to them in other states of the Union. The law in Texas is that the right to a jury trial extends to disputed issues of fact in equitable as well as legal proceedings. *Jeter v. Associated Rack Corp.*, 607 S.W.2d 272, 277-78 (Tex. Civ. App. - Texarkana 1980, writ ref'd n.r.e.), cert. denied, 454 U.S. 965, 102 S.Ct. 507, 70 L. Ed.2d 381 (1981).

The law in Texas, then, is clear that the right to a jury trial extends to disputed issues of fact in equitable, as well as legal, proceedings. See also, *Arce v. Burrow*, 958 S.W.2d 239 (Tex. App. - Houston [14th Dist] 1997)

A jury, however, may not determine the expediency, necessity, or propriety of equitable relief. These matters should be decided by the judge. See *Caballero v. Central Power and Light Company*, 858 S.W.2d 359 (Tex. 1993); *Fontenot, supra*, 716. The *Arce* court held (at 250) that:

> it is equally clear that a jury may not determine the expediency, necessary or propriety of equitable relief. Id. (citing *State v. Texas Pet Foods, Inc.*, 591 S.W.2d 800, 803 (Tex. 1979). So while the parties are entitled to have the jury determine whether there has been a breach of fiduciary duty, they are not entitled to have the jury determine the amount, if any, of the fee forfeiture because fee forfeiture is not an issue of fact, it is a remedy. As stated by the supreme court in [*Caballero, supra*] "[We] hold that when properly requested jury trials are appropriate for finding the ultimate issues of fact ... but not for fashioning appropriate equitable relief." In light of this longstanding tradition, we are compelled to hold that the trial court is to determine the amount of forfeiture, if any, and in making this decision, is to consider the factors held by this court to be relevant to that determination.

See also: 1 Roy W. McDonald, *Texas Civil Practice §*4.4 (rev 1992); Vans Hecke, *Trial By Jury In Equity Cases*, 31 N.C. L.R.157.

3.1.5 **Equitable Remedies:** If plaintiffs in Texas who assert equitable causes of action are entitled to jury trials then what difference does it make whether or not the cause of action is legal or equitable? First, a jury in Texas may not determine the expediency, necessary or propriety of equitable relief. See *Texas Pet Foods, Inc., supra.* Second, equitable remedies are more flexible than legal remedies.

See *Pomeroy's Equity Jurisprudence* (Fifth Edition) §109:

> The distinguishing characteristics of legal remedies are their uniformity, their unchangeableness or fixedness, their lack of adaptation to circumstances, and the technical rules which govern their use. The legal remedies by action are, in fact, only two: recovery of possession of specific things, land or chattels, and the recovery of a sum of money. When a person is owner of land or of chattels in such a way that he is entitled to immediate possession, he may recover that possession; but since the action of

> "Ejectment" has taken the place of the old real actions, a recovery of the land by its means does not necessarily determine or adjudge the Title, and in a recovery of chattels by the action of replevin, the title is only determined in an incidental manner. For all other violations of all possible primary rights, the law gives, as the only remedy, the recovery of money, which may be either an ascertained sum owed as a debt, or a sum by way of compensation, termed damages. Equitable remedies, on the other hand, are distinguished by their flexibility, their unlimited variety, their adaptability to circumstances, and the natural rules which govern their use. There is in fact no limit to their variety and application; the court of equity has the power of devising its remedy and shaping it so as to fit the changing circumstances of every case and the complex relations of all the parties. (emphasis added)

Scott, supra at §199 provides that:

> A court of equity, having jurisdiction over the administration of trusts, will give to the beneficiaries of a trust such remedies as are necessary for the protection of their interests.

See also *Scott, supra* at 199.1:

> The beneficiaries of a trust can maintain a suit in equity to compel the trustee to perform his duties as trustee. Since the rights of a beneficiary and the duties of the trustee to him are equitable rights and duties, his situation is different from that of one who seeks specific performance of a contract of specific redress for a tort. A court of equity will not normally specifically enforce a contract or specifically redress a tort if the remedy of damages at law is regards as an adequate remedy, as in the case of contracts or torts with respect to chattels that are not unique. The beneficiary of a trust, however, is entitled specifically to enforce the trust, even though the subject matter of the trust is ordinary chattel. Normally, as has been stated, the beneficiary's remedies are exclusively in equity, and even though he may have a remedy at law he is not compelled to pursue it but is entitled to relief in equity. And in equity the court will not merely give him damages, but will compel the trustee specifically to perform his duties under the trust.
>
> As has been stated, the trustee is under a duty to the beneficiaries to make an accounting with respect to his administration of the trust. The court will specifically enforce this duty, and compel the trustee to render a proper accounting to the court, and thereupon will give such relief, if any, as the beneficiaries may be entitled to receive. The trustee himself is entitled to have his accounts settled by the court.
>
> Where there is doubt as to the extent or scope of the duties of the trustee, the beneficiaries can maintain a suit in equity in order to obtain the instructions of the court to the trustee as to his duties. The trustee himself in such case can bring a bill for instructions.

Equitable remedies will be dealt with more specifically below. The main point to remember here is that equitable remedies are very, very broad and may be specifically fashioned to redress any equitable wrong.

4 THE TRUST LITIGATION PARADOX:

4.1 **THE PARADOX:** To understand this paradox one must first understand the nature of a trust. The trustee of a trust holds bare legal title and the right to possession of trust assets, while the beneficiary is considered the real owner of the property, holding equitable or beneficiary title. *Burns v. Miller, Hiersche,*

Martens & Hayward, P.C., 948 S.W.2d 317 (Tex. App.- Dallas, 1997); *Hallmark v. Port/Cooper-T. Smith Stevedoring Co.*, 907 S.W.2d 586, 589 (Tex. App. - Corpus Christi, no writ); *Dierschke v. Central Nat'l Branceh of First Nat'l Bank at Lubbock*, 876 S.W.2d 377, 381.(Tex. App. - Austin 1994, no writ). The court in Rigell v Rigell, 960 S.W.2d 144 (Tex. App. - Corpus Christi 1997) held that:

> A trust is a method used to transfer property....The beneficiaries of a valid trust become the owners of the equitable or beneficial title to the trust property and are considered the real owners. *Hallmark v. Port/Cooper-T. Smith Stevedoring Co.*, 907 S.W.2d 586, 589 (Tex. App. - Corpus Christi, no writ)(quoting *City of Mesquite v. Malouf*, 553 S.W.2d 639, 644 (Tex. Civ. app. - Texarkana 1977, writ ref'd n.r.e.) The trustee is vested with legal title and right of possession of the trust property for the benefit of the beneficiaries. *Hallmark*, 907 S.W.2d at 589; *Jameson*, 693 S.W.2d at 680. (emphasis supplied)

In fiduciary litigation by a beneficiary against a trustee there is an inherent paradox involving the trustee, who is usually defending himself out of the trust estate (which belongs more to the beneficiary rather than to the trustee) and the beneficiary who is usually attempting to prosecute the cause fo action against the trustee with his own resources (which in many instances are insufficient to fund the prosecution). In the case of a spendthrift trust, it may be difficult for a beneficiary to even enter into a contingent fee contract for legal representation.

4.2 **EFFECT OF THE PARADOX:** This paradox impacts trust litigation with respect to:

4.2.1 The payment of interim legal fees;

4.2.1.1 In most cases where a beneficiary sues a trustee for breach of trust, the trustee will retain experienced and expensive trust counsel who will invariably attempt to make the beneficiary's prosecution of the cause of action as expensive as possible. The trustee will, of course, seek to charge all interim legal fees and litigation expenses to the trust estate of the beneficiary's trust. Counsel, who are retained by the beneficiary, are usually prosecuting the case on a much more limited budget. and

4.2.2 The disclosure of information to the plaintiff/beneficiary;

4.2.2.1 The books and records of the trust are not the property of the trustee. Again the beneficiary owns equitable title to them and has an absolute right to examine them. In many cases where a beneficiary sues a trustee, the trustee will attempt to restrict the beneficiary's access to this information to the greatest extent possible. In many cases the trustee will try to force the beneficiary to utilize traditional legal discovery rules (rather than equitable rules) to obtain information. These rules were formulated to allow discovery of proprietary information that is owned by a third persons rather than the discovery of trust records that are owned in part by the beneficiaries of the trust.

4.3 **JUDICIAL RECOGNITION OF THE PARADOX:** This paradox is not recognized (or if recognized, not given much credence) by most Texas judges. The practical effect of this is discussed in more detail with respect to the payment of legal fees, litigation expenses, costs and the disclosure of information below.

5 THE TEXAS TRUST CODE AND COMMON LAW:

5.1 **RULES GOVERNING THE ADMINISTRATION OF TRUSTS IN TEXAS:** There are three sets of rules that control the administration of trusts in Texas:

5.1.1 **The Instrument Creating The Trust:** In most situations where the instrument creating the trust deals with a matter - the trust instrument takes precedence over the Texas Trust Code and common law. Tex. Trust Code §111.002 provides that: "If the provisions of this subtitle and the terms of a trust conflict, the terms of the trust

control except that the settlor may not relieve a corporate trustee from the duties, restrictions, and liabilities under Section 113.052 [Loan of Trust Funds To Trustee] or 113.053 [Purchase or Sale of Trust Property by Trustee]." See also Tex. Trust Code §113.001 which provides that: "A power given to a trustee by this subchapter does not apply to a trust to the extent that the instrument creating the trust, a subsequent court order, or another provision of this subtitle conflicts with or limits the power."

5.1.2 **The Texas Trust Code:** The Texas Legislature has codified the Texas Trust Code (Subtitle B of the Texas Property Code). Tex. Trust Code §111.006 provides that the Texas Trust Code applies to (1) all trusts created on or after January 1, 1984, and to all transactions relating to such trusts and (2) to all transactions occurring on or after January 1, 1984, relating to trusts created before January 1, 1984, and which were subject to the Texas Trust Act, as amended (Articles 7425b-1 through 7425b-48, Vernon's Texas Civil Statutes), and the rights, duties and interests flowing from such transactions remain valid on or after January 1, 1984, and must be terminated, consummated, or enforced as required or permitted by this subtitle. If the Texas Trust Code specifically deals with a matter (and the instrument creating the trust does not conflict) then the Texas Trust Code governs the administration of the trust.

5.1.3 **The Common Law:** If neither the trust instrument nor the Texas Trust Code deal with a matter then Texas Common Law governs the administration of the Trust. Tex. Trust Code §111.005 provides that "If the law codified in this subtitle repealed a statute that abrogated or restated a common law rule, that common law rule is reestablished, except as the contents of the rule may be changed by this subtitle."

5.2 **IMPORTANCE OF THE INTERRELATIONSHIP BETWEEN THESE RULES**: In trust litigation it is very important to understand the applicability of these rules to the facts and circumstances of the case with which you are dealing. The nuances of these interrelationships are often lost on counsel participating in trust litigation and, more particularly, on the courts hearing trust litigation cases.

While these interrelationships will be dealt with in more detail below, some possible pitfalls are as follows:

5.2.1 Settlor's Ability To Relieve A Trustee From Duties:

5.2.1.1 Prior to September 1, 2003, Tex. Trust Code §113.059 provided that:

> Except as provided by Subsection (b) of this section, the settlor may relieve the trustee from a duty, liability, or restriction imposed by this subtitle."(emphasis supplied)

5.2.1.2 A recent Texas Supreme Court decision has addressed this issue in some depth. In *Texas Commerce Bank, N.A. v. Grizzle*, 96 S.W.3d 240 (Tex. 2002) the court held that:

> Next, we agree with the TCB and Frost defendants that a trust instrument's exculpatory clause can relieve a corporate trustee of liability for self-dealing defined as the misapplication or mishandling of trust funds, including the failure to promptly reinvest trust monies. We base our decision on the Trust Code's express language.
>
> We start with Trust Code section 111.002, which provides, in part, that "if the provisions of this subtitle and the terms of a trust conflict, the terms of the trust control except the settlor may not relieve a corporate trustee from the duties, restrictions, and liabilities under Section 113.052 or 113.053." Sections 113.052 and 113.053 relate to certain

types of self-dealing. Section 113.052 generally prohibits a trustee from lending trust funds to itself; section 113.053 generally prohibits a trustee from buying trust property from itself and selling trust property to itself. Grizzle does not claim that the TCB or Frost defendants' actions violated sections 113.052 or 113.053. And neither of these statutory provisions defines self-dealing as the court of appeals did here.

Further, Trust Code chapter 113 discusses a trustee's duties in administering a trust. Section 113.051 provides that "[i]n the absence of any contrary terms in the trust instrument or contrary provisions of this subtitle, in administering the trust the trustee shall perform all of the duties imposed on trustees by the common law." In addition, section 117.004(a) provides standards that govern a trustee's duties concerning trust management and investment. That section states:

A trustee shall invest and manage trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements and other circumstances of the trust. In exercising this standard, the trustee shall exercise reasonable care, skill and caution.

Trust Code chapter 114 generally discusses a trustee's liability to the beneficiary for breach of trust. For example, section 114.001 provides, in part:

(a) The trustee is accountable to a beneficiary for the trust property and for any profit made by the trustee through or arising out of the administration of the trust, even though the profit does not result from a breach of trust; ...

(c) A trustee who commits a breach of trust is chargeable with any damages resulting from such breach of trust, including but not limited to:

(1) any loss or depreciation in value of the trust estate as a result of the breach of trust;

(2) any profit made by the trustee through the breach of trust; or

(3) any profit that would have accrued to the trust estate if there had been no breach of trust.

While the Trust Code imposes certain obligations on a trustee--including all duties imposed by the common law -- the Trust Code also permits the settlor to modify those obligations in the trust instrument. Indeed, Trust Code section 113.059 broadly states that a settlor may relieve a corporate trustee from a "duty, liability, or restriction imposed by this subtitle," except for those contained in sections 113.052 and 113.053. The Trust Code contains no other limitations on relieving a corporate trustee from liability for self-dealing in a trust instrument. Thus, we

conclude that the Trust Code allows an exculpatory clause to relieve a corporate trustee from liability for self-dealing defined as misapplying or mishandling trust funds, including failing to promptly reinvest trust monies, unless those activities violate the prohibitions in sections 113.052 and 113.053.

We disagree with the court of appeals' conclusion that public policy precludes such a limitation on liability. The court of appeals based its holding on other courts of appeals' decisions beginning with *Langford v. Shamburger*. To view preceding link please click here *Langford* held that "it would be contrary to the public policy of this State to permit the language of a trust instrument to authorize self-dealing by a trustee."

But as we have previously acknowledged, the State's public policy is reflected in its statutes. And the Legislature has spoken on self-dealing and exculpatory clauses in the Trust Code. The Legislature has expressly authorized the use of exculpatory clauses, stating that they can relieve a corporate trustee from liability except for certain narrow types of self-dealing not at issue here. We therefore decline to hold that a trust instrument cannot exonerate a trustee from liability for failing to promptly reinvest trust monies based on public policy. As we stated in Lawrence v. CDB Services, Inc.:

Public policy, some courts have said, is a term of vague and uncertain meaning, which it pertains to the law-making power to define, and courts are apt to encroach upon the domain of that branch of the government if they characterize a transaction as invalid because it is contrary to public policy, unless the transaction contravenes some positive statute or some well-established rule of law.

We recognize that the Trust Code authorizes a settlor to exonerate a corporate trustee from almost all liability for self-dealing, and that this broad authority can lead to harsh results. But we presume the Legislature was aware of this when it enacted the Texas Trust Act in 1943--the predecessor to the Texas Trust Code--and when it subsequently enacted the Trust Code effective January 1, 1984. When the Texas Trust Act came into being, the Restatement of Trusts § 222 had been written; and when the Legislature enacted the Trust Code, the Restatement (Second) of Trusts § 222 had been written. Both Restatements state, in part: "[a] provision in the trust instrument is not effective to relieve the trustee ... of liability for any profit which the trustee has derived from a breach of trust."

Yet, in addressing self-dealing, the Legislature chose--in the 1943 Trust Act, in the 1983 Trust Code, and again in the current Trust Code--only to prohibit, subject to certain exceptions, exculpatory clauses that permit a corporate trustee to loan trust money to itself, buy trust property from itself, or sell trust property to itself. We therefore conclude

> that public policy, as expressed by the Legislature in the Trust Code, does not preclude a settlor from relieving a corporate trustee from liability for self-dealing, except for what is specified in sections 113.052 and 113.053. We disapprove Langford and its progeny to the extent they suggest otherwise. We further hold that the court of appeals here erred in holding that the Grizzle Trust's exculpatory clause could not relieve the TCB and Frost defendants from liability for misapplying and mishandling trust funds when there was no claim that, by doing so, the TCB and Frost defendants violated sections 113.052 or 113.053.

5.2.1.3 Application of the Grizzle Doctrine: The author interprets this decision to mean that the Texas Supreme Court believes that there are no public policy restrictions on a settlor's right to alter a trustee's responsibilities other than those expressly contained in a trust instrument or in the Texas Trust Code. Most other states provide for public policy limitations on a trustee's activities.

5.2.1.4 It will be interesting to observe how consistent the Supreme Court will be in the future in applying this principal. Texas Trust Code §113.059 deals with the power of the trustor to alter the trustee's responsibilities. Texas Trust Code § 111.002 deals with the relationship between the trust instrument and the Texas Trust Code. §111.002 provides that:

> If the provisions of this subtitle and the terms of a trust conflict, the terms of the trust control, except the settlor may not relieve a corporate trustee from the duties, restrictions, and liabilities of Section 113.052 or 113.053.

What if a trust instrument deprived all courts of jurisdiction oversee and regulate the trust? If there are no public policy restrictions (other than those contained in the Texas Trust Code) on how a settlor can draft a trust instrument, then why wouldn't such a provision be valid?

5.2.1.5 *Grizzle's* impact on other public policy restrictions on settlor's remains to be seen. A conservative interpretation of *Grizzle* would indicate that these cases have also been overruled. For example, the Texas Trust Code does not contain any provision requiring a trustee to furnish periodic accountings to a beneficiary (absent a statutory demand pursuant to Tex. Trust Code §113.151). Pre *Grizzle* Texas Common Law dictated that it was against the public policy of this state to relieve a trustee from all duties to account to the trust beneficiaries. See *Hollenbeck v. Hanna*, 802 S.W.2d 412 (Tex. App. - San Antonio, 1991)

5.2.1.6 Alternatively, pre *Grizzle* courts occasionally refused, on public policy grounds, to enforce the mandatory restrictions set forth in the Texas Trust Code. See *Humane Society of Austin and Travis County v. Austin National Bank*, 531 S.W.2d 574 (Tex. 1975). In this case, the corporate trustee violated a prohibition against lending trust funds to itself (which was one of the mandatory prohibitions set forth in subsection (b) of the above quoted section and therefore could not be waived by the settlor), but the court found that it was not in furtherance of its own self-interest to the detriment of the estate and allowed the transaction.

5.2.1.7 Effective on September 1, 2003, Tex. Trust Code §113.059 was amended to address the *Grizzle* opinion. This section now provides that:

> (a) Except as provided by this section, the settlor by provision in an instrument creating, modifying, amending, or revoking the trust may relieve the trustee from a duty, liability, or restriction imposed by this subtitle."(emphasis supplied)

> (b) A settlor may not relieve a corporate trustee from the duties, restrictions, or liabilities of Section 113.052 or 113.053 of this Act.
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> (c) A settlor may not relieve the trustee of liability for:
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> (1) a breach of trust committed:
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> (A) in bad faith;
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> (B) intentionally, or
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> (C) with reckless indifference to the interest of the beneficiary; or
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> (2) any profit derived by the trustee from a breach of trust.
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> (d) A provision in a trust instrument relieving the trustee of liability of a breach of trust is ineffective to the extent that the provision is inserted in the trust instrument as a result of an abuse by the trustee of a fiduciary duty to or confidential relationship with the settlor.

5.2.1.8 This new provision codifies, in part, §222 of the *Restatement of the Law, Trusts, 2d.* Prior to the *Grizzle* opinion may trust practitioners thought that the provisions of §222 had been incorporated into the common law of Texas. See *Interfirst Bank Dallas v. Risser*, 739 S.W.2d 882 (Tex. App. - Texarkana 1987)

6 TRUST ADMINISTRATION ISSUES:

6.1 DISCRETION: A trust will frequently charge a trustee with the duty to make discretionary decisions with respect to the administration of the estate or trust. These decisions may include discretionary investment decisions, discretionary allocation of receipts and disbursements between the income and principal accounts, discretionary reserves for depletion and depreciation, and most frequently, discretionary income and principal distribution powers. Frequently the instrument granting discretionary decisions will provide that the exercise of discretion is "absolute," "uncontrolled" or in the "sole" discretion of the trustee.

6.2 TRUST DISTRIBUTION STANDARDS:

6.2.1 Preliminary Matters:

6.2.1.1 The Distribution Standard: The distribution standard is the provision in a trust instrument that directs the trustee to distribute a part of the trust estate of the trust to one or more of the trust beneficiaries.

6.2.1.2 Applicability of Distribution Standards to the Distribution of Income and Principal: A distribution standard may apply to the distribution of income, corpus, or both income and corpus. A trust may have one type of distribution standard that governs the distribution of income and a completely different type of distribution standard that governs the distribution of corpus.

> A distribution standard may either govern distributions of all or a portion of the trust estate of a trust during its administration or distribution of the entire trust estate of the trust on termination.

6.2.2 **Applicability of the Distribution Standard to Beneficiaries:** The trust distribution standard may permit distribution to a single beneficiary (to “my wife”), to a class of

beneficiaries having the same relationship to the settlor (to "my children"), or to a class of beneficiaries having different relationships to the settlor (to "my descendants"). If distribution may be made to a class of beneficiaries then the trust is usually referred to as a "spray" trust.

6.2.3 **Instruction Regarding the Exercise of a Distribution Standard**: A well drafted trust will frequently contain provisions assisting the trustee in the application of the distribution standard.

Instruction may be either precatory or mandatory and may apply to any type of distribution standard. There is no standard form for these provisions; they should embody the settlor's intent in creating the trust.

An example of instruction with respect to a spray trust might be as follows:

> "It is not my intention to provide for equal distribution of the income or principal of this trust to support all of my children so long as any one or more of them is actively seeking a reasonable level of college or post graduate education and is expending reasonable effort toward attaining this end. Once a child attains his highest reasonable level of education then I am no longer as interested in supporting such child as I am in providing for the support and education of such child's siblings who have not completed such level of education.
>
> I realize that my children may have different desires regarding college or post graduate education and that the cost of educating one or more of my children may greatly exceed the cost of educating other of my children.
>
> Rather than have the trust estate of this trust diminished when one or more of my older children complete their education I would prefer for the entire trust to remain intact until such time as my youngest living child attains the highest level of education reasonably available to him or her. Once this occurs, I desire for all future distributions to be made to my children in equal shares.
>
> Without limiting the foregoing I also wish to provide for the health of all of my children and, to this end my trustee is authorized to make unequal distributions to any one or more of my children that have special health needs."

Note that these instructions both assist the trustee in exercising discretionary distribution decisions and modify the fiduciary duty of impartiality described below.

6.2.4 The Fiduciary Duty of Impartiality: The fiduciary duty of impartiality overlays every distribution decision. The fiduciary duty of impartiality is discussed in subsequent provisions of this paper.

The exercise of a discretionary distribution power may affect both income beneficiaries and remainder beneficiaries. For example, if the trustee makes distributions to the income beneficiaries, this may reduce the value of the trust estate of the trust that is ultimately available to the remainder beneficiaries. Conversely, if the trustee refuses to make distributions to the income beneficiaries, this may increase the trust estate that is ultimately available to the remainder beneficiaries.

The duty of impartiality obviously comes into play when there are multiple beneficiaries eligible for the same distributions. For example, in situations where the trustee of a spray trust has discretion to distribute income among a class of beneficiaries consisting of numerous beneficiaries the duty of impartiality will always be a consideration.

This duty may be modified or eliminated by the settlor. The author recommends that if a trustee is given discretionary distribution powers then consideration should be given to putting specific language in the trust that modifies or eliminates this duty. This is especially important with respect to spray trusts.

6.2.5 There Is No Such Thing as Absolute Discretion: The discretion with which a trustee of a trust is clothed to determine how much of the trust property shall be made available for the support of the beneficiary and when it shall be used is not an unbridled discretion. *Rubion v. Rubion*, 158 Tex. 43, 308 S.W.2d 4 (Tex. 1957); *First National Bank of Beaumont v. Howard*, 149 Tex. 130, 229 S.W.2d 781 (Tex.1950). He may not act arbitrarily in the matter, however pure his motives. *In Re Browns Appeal*, 345 Pa. 373, 29 A.2d 52; *Restatement of Trusts, Sec.* 187, p.487; 90 *C.J.S. Trusts* §261, p.310. His discretion must be reasonably exercised to accomplish the purposes of the trust according to the settlor's intention and his exercise thereof is subject to judicial review and control.

See also *Restatement of The Law of Trusts, 2d* §187 which provides that:

> Where discretion is conferred upon the trustee with respect to the exercise of a power, its exercise is not subject to control by the court, **except to prevent an abuse of the trustee of his discretion**. (emphasis supplied)

Issues involving court intervention are much more prevalent in connection with support trusts than with pure discretionary trusts. Courts will generally not substitute their discretion for that of the trustee in a pure discretionary trust unless the acts of the trustee are completely outside the bounds of reasonable conduct.

6.2.6 Criteria Applicable to the Exercise of Discretion: There are numerous criteria that should be considered by the trustee in formulating his, her or its exercise of discretion. These always include the component elements, if any, that are actually contained in the distribution standard (such as “health”, “support”, “maintenance”, “education”, “welfare”, “comfort”, “best interest” etc.).

There are additional factors that a trustee may want to consider in exercising discretion. Many times one or more of these factors will be set forth in the instrument creating the trust. Even if they are not set forth in the instrument creating the trust, the trustee may consider:

6.2.6.1 Other Sources Of Income: The trustee may consider whether or not the beneficiary is also the beneficiary of other trusts which would provide for the beneficiary and if these trusts are, in fact, making distributions to the beneficiary.

6.2.6.2 Other Assets: The trustee may consider what other assets the beneficiary owns and whether or not these assets generate sufficient income to provide for the beneficiary.

6.2.6.3 Other Income: The trustee may consider other income that the beneficiary is actually receiving. For example, is the beneficiary employed? How much is the beneficiary paid by virtue of this employment?

6.2.6.4 Accustomed Standard of Living: The trustee may consider the accustomed standard of living that the beneficiary enjoyed at the time of the creation of the trust; or, at the time that the anticipated distribution is to be made.

6.2.6.5 Special Health Problems: The trustee may consider any unusual mental or physical health problems that the beneficiary may have at the time. Do these problems prevent the beneficiary from earning income? What is the cost of treatment? To what extent does the beneficiary have health insurance that will provide for these problems?

6.2.7 Facilities of Payment Distributions: Many trusts will contain a "facilities of payment" clause. An example of such a clause is:

> Notwithstanding anything to the contrary in this instrument, the Trustee, in its sole discretion, may make any distribution required or permitted to be made under this instrument in any of the following ways (regardless of whether or not the beneficiary is a minor or is incapacitated):
>
> 1. to the beneficiary directly;
>
> 2. to the guardian of the beneficiary's person or estate;
>
> 3. by utilizing the distribution, without the imposition of a guardian or any other person, for the health, support, maintenance or education of the beneficiary;
>
> 4. by paying the distribution to third persons in accordance with written instructions from the beneficiary;
>
> 5. to a custodian for the minor beneficiary under the Texas Uniform Transfer to Minors Act or a uniform gifts to minors act of another state; or
>
> 6. by reimbursing the person who is actually taking care of the beneficiary, even though the person is not the legal guardian, for expenditures made by the person for the benefit of the beneficiary.

While the principal purpose of this type of clause is to allow the trustee flexibility to provide needs of trust beneficiaries, a facilities of payment clause may be used in some situations to provide for a beneficiary in a manner that can not be attached by creditors.

6.2.8 Abuse of Discretion: In general, a court will not substitute its own discretion for that of a trustee, however, the court will not permit him to abuse the discretion. See *Coffee v. William Marsh Rice University*, 408 S.W.2d 269 (Tex. Civ. App.-Houston, 1966, writ ref'd n.r.e.); *Brown v. Scherck*, 393 S.W.2d 172 (Tex. Civ. App.-Corpus Christi, 1965, no writ) and *Nations v. Ulmer*, 122 S.W.2d 700 (Tex. Civ. App.-El Paso, 1938, writ dism'd).

An abuse of discretion does not usually occur unless the trustee acts outside the bounds of "reasonable judgment." *Scott on Trusts* § 187. A court should look to the following factors in determining whether a fiduciary has abused his discretion in making a trustee decision:

1. the extent of discretion conferred;

2. the existence of a definable external standard by which the reasonableness of the trustee can be judged;

3. if such a standard exists, the due diligence the trustee used to obtain the facts necessary to comply with this standard;

4. the circumstances surrounding the decision;

5. the factors that the trustee considered in making the decision;

6. the motives of the trustee; and

7. whether or not the trustee had a conflict of interest when making the decision.

6.2.9 Failure to Exercise Discretion: Failure to Exercise Discretion: It is an abuse of discretion for a trustee to fail to exercise judgment at all, no matter how broad the standard. *Scott on Trusts* § 187.3. A trustee can exercise its fiduciary duties in such a negligent manner that the lack of diligence will result in a breach of trust. *Jewett v Capital Nat'l Bank of Austin*, 618 S.W.2d 109 (Tex.App. - Waco, 1981, writ ref'd n.r.e)

6.2.10 Self Settled Trusts: The rules set forth below, with respect to immunity from creditors claims, do not apply to self settled trusts. See *Restatement of the Law of Trusts*, 2d. §156 provides that:

> (1) Where a person creates for his own benefit a trust with a provision restraining the voluntary or involuntary transfer of his interest, his transferee or creditors can reach his interest.
>
> (2) Where a person creates for his own benefit a trust for support or a discretionary trust, his transferee or creditors can reach the maximum amount which the trustee under the terms of the trust could pay to him or apply for his benefit.

See also *Bank of Dallas v. Rebublic National Bank of Dallas*, 540 S.W.2d 499 (Tex. App. – Waco, 1976, writ ref'd n.r.e).

6.3 PURE DISCRETIONARY DISTRIBUTION STANDARD: A trust is a discretionary trust if the trustee is authorized to make distributions in his sole discretion which is not subject to any objective standard.

A description of discretionary trusts is contained in Section 228 of *Bogert, Trusts and Trustees*, which provides that:

> A settlor may provide that his trustee shall have absolute and uncontrolled discretion whether to pay or apply trust income or principal to or for the benefit of a named beneficiary, without fixing any standard or guide which the trustee is to consider and that the income which the trustee does not elect to use for the beneficiary shall be accumulated or paid to another or to a class of other persons. Such a trust has been called a "discretionary trust" and this term has a technical meaning for the purpose of determining the rights of the beneficiary and his assignees and creditors. It must be distinguished from trusts where the discretion of the trustee pertains only to the time or manner of the payments, or to the size of the payments needed to achieve a certain purpose, for example, to support the beneficiary. The trustee must have complete discretion to pay or apply or to totally exclude the beneficiary, if the trust is to be called "discretionary" in a technical sense.

6.3.1 Example of the Standard:

> *Until this trust terminates, my trustee is granted absolute discretion to distribute all or any portion of the income and/or corpus of this trust to any one or more of the beneficiaries of the trust to the entire exclusion of any other beneficiary or beneficiaries of the trust or to refuse to make any distributions whatsoever to any beneficiary of this trust. In exercising this discretion my trustee shall not be subject to the fiduciary duty of impartiality and may apply any criteria that it deems necessary in its absolute discretion to determine whether or not any distribution should be made and the amount and type of any distribution.*

6.3.2 Springing Discretionary Standard: A distribution standard may be purely discretionary from the inception or may, on the occurrence of a triggering event, convert into a purely discretionary distribution standard. In other words, a distribution standard could be a pure support standard but could provide that if a creditor of any beneficiary makes a claim against the trust estate of the trust - the standard permanently converts into a pure discretionary standard.

6.3.3 Right of a Beneficiary to Compel Distribution**:** The beneficiary of a purely discretionary trust may not compel the trustee to make trust distributions. See *Burns v. Miller, Hiersche, Martens & Hayward, P.C.*, 948 S.W.2d 317 (Tex. App. – Dallas, 1997, writ den'd); *Restatement of The Law of Trusts 2nd* §155, comments note e.

See also *Ridgell v. Ridgell*, 960 S.W.2d 144 (Tex. App. – Corpus Christi, 1997 (no writ)); and *Kolpack v. Torres*, 829 S.W.2d 913 (Tex. App. Corpus Christi, 1992, writ den'd):

> Under a discretionary trust, the beneficiary is entitled only to the income or principal that the trustee in her discretion, shall distribute to him. G. Bogert, *The Law of Trusts and Trustees* §228 (2d ed. 1979). The beneficiary of a discretionary trust cannot compel the trustee to pay him or to apply for his use any part of the trust property, nor can a creditor of the beneficiary reach any part of the trust property until it is distributed to the beneficiary.

In extraordinary situations a beneficiary may be able to convince a court that the trustee of a purely discretionary trust's failure to exercise discretion was so unreasonable as to constitute a breach of trust and/or to merit court supervision. For example, if the sole beneficiary of a multimillion dollar discretionary trust were to have a medical problem that could cause his death if he did not receive treatment, and if he did not have sufficient resources outside of the trust to provide for the treatment, then if the trustee refused to pay for the treatment, then the beneficiary might be able to compel distribution for his medical treatment.

6.3.4 Right of a Beneficiary to Transfer Interest: Absent spendthrift restrictions in the trust, a beneficiary probably may transfer his interest in a purely discretionary trust to a third person. It is doubtful, however, that a third person would have much of an interest in acquiring a discretionary distribution interest that he can not enforce. Even if a third person acquired a beneficiary's discretionary distribution interest - the third person would not become a beneficiary of the trust in a normal sense; the discretionary distribution beneficiary would continue to be the person designated in the trust.

6.3.5 Right of a Creditor or Transferee to Attach: A creditor may not attach a beneficiary's discretionary distribution interest until it is distributed to the beneficiary. *Ridgell, supra* and *Kolpack, supra.*

Neither a creditor nor a transferee may compel a distribution from a pure discretionary trust. See *Restatement of Trusts 2nd* §155 (1) which provides that:

> Except as stated in §156 [imposing special rules for self-settled trusts], if by the terms of a trust it is provided that the trustee shall pay to or apply for a beneficiary only so much of the income or principal or either as the trustee in his uncontrolled discretion shall see fit to apply, **a transferee or creditor of the beneficiary can not compel the trustee to pay any part of the income or principal.** (emphasis supplied)

A trustee may not, however, make any further discretionary distributions to the trust beneficiary after receiving notice of a transfer of the discretionary distribution interest or notice of attachment of the interest by a creditor of the beneficiary. See *Restatement of Trusts 2nd* §155 (2) which provides that:

> Unless a valid restraint on alienation has been imposed in accordance with the rules stated in §§152 and 153 [dealing with spendthrift provisions], if the trustee pays to or applies for the beneficiary any part of the income or principal with knowledge of the transfer or after he has been served with process in a proceeding by a creditor to reach it, he is liable to such transferee or creditor.

6.4 **PURE SUPPORT DISTRIBUTION STANDARD**: A trust is a support trust if it contains a distribution standard. The distribution standard of a support trust is generally an "ascertainable standard."

The standard is ascertainable because it is specific enough to be objectively applied. The distribution standard in a typical support trust permits distribution for the "health, support, maintenance and education" of the beneficiary.

The trustee of a support trust has discretion to determine the amount of income (and/or, if applicable, principal) necessary to provide for the support of the beneficiary. This discretion, however, is limited. See *Rekdahl v. Long*, 407 S.W.2d 339 (Tex. App. – Eastland, 1966, aff'd 417 S.W.2d 387 (Tex. 1967)); *State v. Rubion*, 308 S.W.2d 4 (Tex. 1957):

> The discretion with which a trustee of a support trust is clothed in determining how much of the trust property shall be made available for the support of the beneficiary and when it shall be used is not an unbridled discretion. *First National Bank of Beaumont v. Howard*, 149 Tex. 130, 229 S.W.2d 781, 785; *Anderson v. Menefee*, Tex. Civ. App., 174 S.W. 904, writ refused; *Scott on Trusts*, Vol 2, sec. 187, p. 487; 90 C.J.S. Trusts §261, p. 310. His discretion must be reasonably exercised to accomplish the purposes of the trust according to the settlor's intention and his exercise thereof is subject to judicial review and control. *Scott on Trusts*, secs. 187, 187.1, 187.2, and 187.3; *Kelly v. Womack*, 153 Tex. 371, 268 S.W.2d 903, 907; *Powell v. Parks* 126 Tex. 338, 86 S.W2d 725; *Davis v. Davis*, Tex. Civ. App., 44 S.W.2d 447, no writ history.

6.4.1 Example of the Standard:

> *Until this trust terminates, my trustee shall pay or apply only so much of the income and/or corpus of the trust for the support or education of my son John.*

6.4.2 Right of a Beneficiary to Compel Distribution: The beneficiary of a support trust may compel distribution from the trustee.

6.4.3 Right of a Beneficiary to Transfer Interest and the Right of Creditors to Attach the Interest: *The Restatement of The Law of Trusts, 2d* §154 deals with support trusts that are solely for "education and support" of the beneficiary and provides that:

> Except as stated in §§156 and 157 [situations where the settlor is a beneficiary and certain public policy considerations], if, by the terms of a trust it is provided that the trustee shall pay or apply only so much of the income and principal or either as is necessary for the **education and support** of the beneficiary, the beneficiary cannot transfer his interest and his creditors cannot reach it.

Comment *e*. to this section provides that "The rule stated in this section is not applicable where the amount to be paid by the trustee is a specified sum or is not limited to what is necessary for the education and support of the beneficiary, although by the terms of the trust it appears that the settlor's motive in creating the trust is to provide for the education or support of the beneficiary. "

Texas case law is in agreement with this Restatement rule. See *e.g.*, *Monday et al v. Vance et. al,* 51 S.W. 346 (Tex. App., 1899):

> ... it is also true that the right of alienation by the beneficiaries in the deed in question is utterly inconsistent with the purposes of the trust. The trust is an active one. The deed makes it the duty of the trustee to manage and control the property so as to produce the greatest possible income, and to appropriate the entire net income to the support of Mrs. Rice and to the education and maintenance of her children, and the means of educating the latter. To permit an alienation of the interest of the beneficiaries is destructive of the trust and incompatible with its purposes. In such cases the authorities hold that there is no power of alienation, although no restrictions upon the power are expressed in the conveyance.

Most support trusts contain the "safe harbor" distribution standard contained in Internal Revenue Code § 2041 (b) (1) (A). This standard is "health, support, maintenance and education". The regulations under I.R.C. §2041 (b)(1)(A) provide that "as used in this subparagraph, the words "support" and "maintenance" are synonymous in their meaning and are not limited to the bare necessities of life."

While there is no Texas authority directly on point, it is the author's opinion that the Restatement §154 Rule would apply to support trusts containing the I.R.C. 2041(b)(1)(A) distribution standard.

6.5 NON ASCERTAINABLE DISTRIBUTION STANDARD: A trust may purport to be a support trust but may impose a non-ascertainable distribution standard on the trustee. The distribution standard is non-ascertainable because it may not be objectively applied.

This type of distribution standard is for the "general welfare", "comfort", "best interest" or "well being" of the beneficiary. This imposes a standard that is so broad that it is difficult to ascertain exactly what the beneficiary is entitled to receive.

Because there is a distribution standard, the trust is not, in a pure sense, discretionary. The beneficiary may compel distribution under this standard and the beneficiary's creditors may, in the absence of spendthrift provisions, attach a beneficiary's undistributed interest.

6.5.1 Example of the Standard:

> *Until this trust terminates, my trustee shall pay or apply income and/or corpus of the trust for the welfare and comfort of my son John.*

6.5.2 Right of a Beneficiary to Compel Distribution**:** The beneficiary of a trust containing a non ascertainable distribution standard may compel distribution from the trust. In fact, the standard may cause the entire trust estate of the trust to be included in the beneficiary's federal estate tax base.

6.5.3 Right of a Beneficiary to Transfer Interest**:** In the absence of spendthrift provisions, the beneficiary of a trust with a non ascertainable distribution standard may transfer his or her interest in the trust to a third party.

6.5.4 Right of a Creditor to Attach: The creditors of a beneficiary of this type of trust probably can compel distribution and may attach the trust estate of this type of trust.

6.6 **"DISCRETIONARY" ASCERTAINABLE DISTRIBUTION STANDARD:** A trust may authorize a trustee to apply an ascertainable distribution standard in the trustee's discretion.

This type of standard might authorize the trustee to distribute to a beneficiary "so much of the income of the trust as the trustee were to determine, in its absolute and uncontrolled discretion, to be necessary for the health, support, maintenance and education of the beneficiary".

Because there is a distribution standard, the trust is not, in a pure sense discretionary. The beneficiary may compel distribution under this standard and the beneficiary's creditors probably can attach, in the absence of spendthrift provisions, a beneficiary's undistributed interest.

The trustee's discretion in making this type of distribution is never absolute. It is always subject to review by a court of competent jurisdiction if the trustee acts outside the bounds of "reasonable judgment".

6.6.1 Example of the Standard:

> *Until this trust terminates, my trustee shall pay or apply so much of the income and/or corpus of the trust as it, in its absolute and uncontrolled discretion, determines to be necessary for the health, support, maintenance or education of my son John.*

6.6.2 Right of a Beneficiary to Compel Distribution**:** The beneficiary of this type of trust may compel distribution from the trustee. Notwithstanding the imposition of discretionary language, this is probably nothing more than a support trust.

6.6.3 Right of a Beneficiary to Transfer Interest and the Right of Creditors to Attach the Interest: This type of trust is subject to the same restrictions as support trusts (set forth above).

6.7 **DISCRETIONARY DECISIONS INDIRECTLY INFLUENCING DISTRIBUTIONS:**

6.7.1 Discretion Regarding Allocation of Receipts and Disbursements**:** Many trusts will grant the trustee the discretionary power to allocate receipts between the income and principal accounts of the trust. If the trust distribution standard provides that "all income" shall be distributed to the beneficiary, then the discretionary allocation to income will determine the amount that is distributable to the beneficiary.

6.8 **SPECIAL PROBLEMS:**

6.8.1 Beneficiary Fails/refuses to Supply Information**:** The beneficiary of a discretionary trust will occasionally fail or refuse to give the trustee sufficient information to make an informed decision regarding the exercise of the standard. When this occurs the trustee has three alternatives: (1) not to make the discretionary distribution; (2) to make the discretionary distribution without sufficient information; or (3) to seek judicial instruction. The author does not have a solution to this problem. If there is substantial acrimony between the trustee and the beneficiary and the amount involved is substantial then the trustee should probably seek court instruction. If the trust is purely discretionary the beneficiary could probably never compel a distribution after refusing to supply information. The problem is obviously much more complicated when support trusts are involved.

6.9 **INVESTMENT DECISIONS**: The trustee must make investment decisions pursuant to his fiduciary duty of prudence set forth in the trust instrument or, in default, new Chapter 117 of the Tex. Trust Code (the Uniform Prudent Investor Act). This Act, which applies to existing trusts as well as trusts created after its effective date of January 1, 2004, changes the long standing "prudent man" rule and, in some cases, Texas common law. Overlying the fiduciary duty of prudence are many other fiduciary duties (the most important of which are those of loyalty and impartiality).These duties will be dealt with in more detail below. There are, however, several general matters that should be considered in reviewing a trustee's investment performance. Most of these are very complex and will be dealt with below in very general terms.

A trustee's investment duties have been evolving to recognize modern market reality. In Texas the rules governing the standard for investment performance have evolved from the "Individual Investment Test" to the "Modern Portfolio Test". Early Texas law imposed the Individual Investment Test which provided that the prudence of each individual investment in the portfolio was judged independently from prudence of every other investment in the portfolio. The modern portfolio test is now embodied in Tex. Trust Code §117.004(b) and requires that the performance of the entire investment portfolio (rather than the performance of an individual investment) be considered in evaluating a trustee's investment performance. The current evolution of these rules is contained in *Restatement (Third) of Trusts*, §227 - 229 (1992), the Uniform Prudent Investor Act, and the 1997 Uniform Principal and Income Act.

In the past, many corporate trustees would "sweep" trust checking accounts into a master interest bearing account and keep the interest earned on the account. While the interest earned with respect to an individual trust account would be small the interest earned on the sweep account could be substantial. Due to litigation in this area most banks have abandoned this practice. A beneficiary, however, should be aware of the practice and the potential breach of the fiduciary duty of loyalty and self dealing.

Many bank trust departments historically maintained a "Chinese Wall" between the trust department and the commercial bank. The thought was that a trust department should not share information about its beneficiaries with the commercial bank. Modern banking practice has shattered the Chinese Wall. Many banks have now created "Personal Banking Departments" which include trust functions and personal lending functions. Instead of the Chinese Wall, modern banking practice is to utilize all aspects of the trust relationship to cross sell banking services. Frequently the Personal Banking Departments (and their subsidiary trust departments), are managed by lending officers rather than trust officers. The result of this is often total disregard of many traditional trust department safeguards. For example, if a trust borrows money from the bank and the loan comes up for renewal, the borrowing trust officer may well negotiate the renewal with the lending personal loan officer and both officers may report to the same person (who heads the Personal Banking Department). While there are many other potential breaches of trust - a beneficiary may want to carefully review transactions within this department in evaluating the performance of his trustee.

Other evolutionary events that should be considered in connection with a beneficiary's examination of the investment performance of a corporate trustee include bank's response to the competition between brokerage firms and banks. Historically banks invested trust funds in so called "Common Trust Funds" which were regulated by the federal government. Federal regulations prevented the

bank from making any fees withing the fund (i.e. charging investment fees that were taken out of the fund prior to computing the return on individual shares). In order to compete brokerage firms many banks have created so called "open-end and closed-end management investment companies and/or investment trusts registered under the Investment Company Act of 1940 (15 U.S.C. Sec. 80a-1 et. seq.). These are similar to mutual funds (and will be subsequently referred to as "In House Mutual Funds") and are marketed by the bank to both trust and individual customers. The bank may charge internal fees with respect to these funds. Many banks have liquidated their common trust funds (after lobbying special legislation that prevents such liquidation from being subject to capital gains tax) and have invested the proceeds in their In House Mutual Funds. In order to get around obvious breaches of the fiduciary duty of loyalty these banks attempt to reduce the fees charged to trust customers to compensate for the internal fees that they charge for management of the fund. If a beneficiary is examining the performance of a corporate trustee that engages in these transactions then careful scrutiny should be given to whether or not the bank is receiving any profit from the use of his trust estate or is charging any unauthorized and/or undisclosed fees withing the In House Mutual Fund. The beneficiary should also look at the investment of the In House Mutual Fund to determine if the fund is used to benefit (through investment in securities) favored customers of the bank or related or affiliated companies and/or if the bank receives any indirect benefit from any aspect of the funds investment portfolio.

Individual trustees will often invest the trust estate in investment accounts at brokerage firms. They seldom, if ever, read the contracts that govern these accounts. The contracts of most national brokerage firms have very one sided (and remarkably similar) provisions protecting the brokerage firm from liability in the event of their negligence. These typically: deny the account holder the right to a trial, force arbitration, subject the account to the laws of a foreign jurisdiction (usually those of New York), limit discovery and provide hidden bars to recovery (for example, they may provide that if an account holder does not institute action within a very short time after receiving his monthly statement, he waives all right to complain). It is the author's opinion that it is a breach of trust for a trustee to place trust estate property in this type of account. If loss occurs to the trust estate because of one or more of these provisions, the trustee will undoubtedly be liable.

6.10 **ALLOCATION OF RECEIPTS AND DISBURSEMENTS:** Trust accounting involves the establishment of an income account and a principal account for bookkeeping purposes. The income account is available for distribution to the income beneficiaries according to the distribution standard contained in the trust. The principal account is available for distribution to the beneficiaries of the trust (either income beneficiaries or remainder beneficiaries) according to the distribution standard contained in the trust.

The allocation of receipts involves a determination of what receipts constitute income and what receipts constitute principal. The trustee must also allocate disbursements between the income and principal accounts of the trust.

Virtually every allocation of receipts and disbursements involves the fiduciary duty of impartiality. Any allocation effects the interests of either the income beneficiaries or the remainder beneficiaries. For example, the allocation of a receipt to the income account favors the income beneficiaries and the allocation of a disbursement to the income account is adverse to the income beneficiaries. Conversely, the allocation of a receipt to the principal account favors the remainder beneficiaries and the allocation of a disbursement to the principal account is adverse to the remainder beneficiaries.

In the absence of contrary provisions in the trust instrument, the default rules governing the allocation of receipts and disbursements are contained in Chapter 116 of the Texas Trust Code (Tex. Trust Code §116.001 - 116.206), essentially the 1997 version of the Uniform Principal and Income Tax, although some of the provisions have been changed from the Uniform Act.

While some areas of discretion are eliminated under the rules, such as the provisions of Tex. Trust Code §113.111(a) directing that trustee's compensation and advisors be paid one-half from income and one-half from principal. Tex. Trust Code §§116.201 and 116.202. However, discretion is left as to the payment of attorney's fees. Tex. Trust Code §116.051(2)(B) and (C).

Trust instruments will frequently provide that the allocation of receipts and disbursements will be within the discretion of the trustee (rather than in the manner provided in the Texas Trust Code). In these cases the trustee probably does not have absolute discretion. For example:

Individual trustees seldom make allocations correctly. They usually employ CPA's who more often than not will prepare trust accounts in accordance with business or tax accounting standards that have no applicability to trust accounting.

Corporate trustees utilize computer programs to make allocations. These programs frequently make the same allocations for all trusts that the bank is administering.

It is usually impossible for the computer programs to exercise the discretion required to make discretionary allocations. Corporate trustees will often use the same computer program to allocate receipts and disbursements when there are special provisions in the will mandating allocations or granting broad discretion in making allocations. These corporations may be guilty of failure to exercise discretion with respect to these allocations. As we will say later, this is a problem under both Uniform Acts.

6.11 **OVERDRAFT OF ACCOUNTS:** Some corporate trustees will occasionally "overdraft" the income account of a trust. This is done in situations where a fixed payment is due (such as taxes or trustee's commissions) and there is not sufficient funds in the income account to make the payment.

An income overdraft constitutes a loan to the income beneficiary from the principal account of the trust. Trustees seldom, if ever, charge interest to the income beneficiary when the income overdraft is repaid. This activity may constitute a breach of the fiduciary duty of impartiality to the remainder beneficiaries of the trust.

In situations where the income beneficiary is entitled to distributions from both income and/or principal (subject to the same distribution standard) this practice may not constitute a breach of trust. In situations where the income beneficiary is not entitled to principal distributions and/or the principal distributions to which the beneficiary is entitled are subject to a stricter distribution standard than income distributions, then this practice may constitute a breach of trust.

If the trust is a spendthrift trust, do overdrafts of the income account constitute an impermissible advance of the income beneficiary's interest in the trust? If these overdrafts accumulate, what rights does the trustee have to offset them against the income beneficiary's future interest in the trust? These questions have yet to be resolved by Texas law and are not dealt with under the Uniform Principal and Income Act

7 FIDUCIARY DUTIES - GENERAL CONSIDERATIONS:

7.1 DISTINCTION BETWEEN "POWERS" AND "DUTIES":

7.1.1 In Trust Litigation issues occasionally arise regarding whether a provision in the trust instrument relates to a trustee's "powers" or a trustee's "duties." This problem is most frequently encountered in connection with language purporting to modify or waive a fiduciary duty. It is sometimes also encountered in connection with the interpretation of exculpatory clauses.

For example, a trust instrument may give a trustee "all of the rights over the trust estate that are possessed by a fee simple owner". Does this language merely expand the power of the trustee to administer the trust estate or does it also relieve the trustee of any of the trustee's common law or statutory fiduciary duties? Similarly, if a trust instrument purported to "relieve a trustee of all of the restrictions contained in the Texas Trust Code" would this language merely expand the power of the trustee to administer the trust estate or does it also relieve the trustee of any of the trustee's common law or statutory fiduciary duties?

It is the author's opinion that broad language of this type does not waive either statutory or common law fiduciary duties. See the specific discussion regarding modification and waiver of fiduciary duties below.

The point to remember is that there is a difference between a trustee's powers and a trustee's duties. This distinction has been recognized in the Texas Trust Act, the Texas Trust Code, and by virtually all of the commentators in the area.

7.2 GENERAL TYPES OF FIDUCIARY DUTIES:

7.2.1 Common Law Fiduciary Duties:

Common law fiduciary duties are duties that have been created by the courts to apply to fiduciaries. These duties may apply to all types of fiduciaries (*e.g.*, executors, trustees, guardians, attorneys, custodians, agents, donees or powers of attorney, bank, partners, joint venturers, or corporate management) or may apply to specific fiduciaries such as trustees only. The duties described in this paper apply to trustees. As a general rule, common law fiduciary duties will be liberally interpreted by the court once the fiduciary relationship has been established.

A statute may codify a common law fiduciary duty. With respect to statutory versus common law duties, Texas Trust Code § 111.005 provides:

> If the law codified in this subtitle repealed a statute that abrogated or restated a common law rule, that common law rule is re-established, except as the contents or the rule are changed by this subtitle. Tex. Trust Code § 111.005 (Vernon 1984);

Tex. Trust Code §113.051 provides that:

> The trustee shall administer the trust according to its terms and this subtitle. In the absence of any contrary terms in the trust instrument or contrary provisions of this subtitle, in administering the trust the **trustee shall perform all of the duties imposed on trustees by common law.** (emphasis supplied)

7.2.2 Statutory Fiduciary Duties:

Statutory fiduciary duties are duties that have been created by the legislature apply to certain designated types of fiduciaries. These duties apply to the type of fiduciary specifically enumerated by the statute. In most cases, the statutory rule simply codifies a common law duty.

There may be a considerable overlap between a common law fiduciary duty and a statutory fiduciary duty (*e.g.*, the Texas Trust Code now codifies the duty of loyalty in a way that is very similar to the common law rule). When such overlap occurs the statutory duty will take precedence over the common law duty.

7.2.3 Fiduciary Duties Created by the Instrument:

The instrument creating the fiduciary relationship (*e.g,*. the will or the trust) may create specific fiduciary duties.

There is usually an overlap between this type of fiduciary duty, statutory fiduciary duties, and common law fiduciary duties (*e.g.*, a trust instrument may override the prudent investor rule or contain a prudent man rule that is slightly different from the common law prudent man rule). Generally when such overlap occurs the duty specified in the instrument will take precedence over both the statutory duty and the common law duty.

There are some fiduciary duties that may not be modified by the instrument creating the fiduciary relationship because of a statutory prohibition. These will be dealt with more extensively below.

There are other fiduciary duties that may not be modified or waived by the instrument creating the fiduciary relationship because of the public policy of this state. These will be dealt with more extensively below.

7.3 MODIFICATION OR ELIMINATION OF FIDUCIARY DUTIES:

7.3.1 Power of the Court to Modify:

Texas Trust Code Ann. § 115.001(8) provides that a court of equity has original and exclusive jurisdiction over proceedings concerning trusts to relieve a trustee from any or all of the duties, limitations, and restrictions otherwise existing under the terms of the trust instrument or the Trust Code. It is clear that a court of equity can modify or eliminate any fiduciary duty (regardless of whether or not the duty is a statutory fiduciary duty, a common law fiduciary duty or a fiduciary duty created by the trust instrument).

7.3.2 Power of Settlor to Modify:

The Supreme Court in the *Grizzle*, *supra*, decision made it clear that the only restrictions on a settlor's ability to modify a fiduciary duty is an express prohibition in the Texas Trust Code.

The Settlor establishes the details of the fiduciary relationship in the trust instrument. In doing so the settlor has wide discretion to modify or eliminate the fiduciary duties of the trustee and/or to protect the trustee from liability for breach of a fiduciary duty. The power to do so is limited only by statutory prohibitions and the public policy of this state.

Texas Trust Code §113.059 provides that:

> (a) Except as provided by this section, the settlor by provision in an instrument creating, modifying, amending, or revoking the trust may relieve the trustee from a duty, liability, or restriction **imposed by this subtitle** ."(emphasis supplied)
>
> (b) A settlor may not relieve a corporate trustee from the duties, restrictions, or liabilities of Section 113.052 or 113.053 of this Act.
>
> (c) A settlor may not relieve the trustee of liability for:
>
> (1) a breach of trust committed:
>
> (A) in bad faith;
>
> (B) intentionally, or
>
> (C) with reckless indifference to the interest of the beneficiary; or
>
> (2) any profit derived by the trustee from a breach of trust.
>
> (d) A provision in a trust instrument relieving the trustee of liability of a breach of trust is ineffective to the extent that the provision is

inserted in the trust instrument as a result of an abuse by the trustee of a fiduciary duty to or confidential relationship with the settlor.

Tex. Trust Code §113.059 provides that statutory duties (i.e. those "imposed by this subtitle") may be modified or eliminated. This does not necessarily mean that any of the common law fiduciary duties may be modified or eliminated, but that is a logical extension of the doctrine in *Grizzle.* The interrelation between fiduciary duties imposed by the common law and fiduciary duties imposed by the Trust Code is complex. While most of the statutory fiduciary duties contained in the Texas Trust Code may be waived, prior to *Grizzle,* many practitioners believed that some common law fiduciary duties may not be waived on public policy grounds. This distinction was unfortunately not addressed in the *Grizzle* decision.

Prior to Grizzle, Texas courts held that some statutory duties could not be waived on public policy grounds even though the Trust Code apparently authorized their waiver. For example, there is nothing in Tex. Trust Code §113.059 that restricts a settlor from totally eliminating the duty to account imposed by Tex. Trust Code §113.151. Pre *Grizzle*, Texas courts, however, concluded that it was against the public policy of the State of Texas for a settlor to totally eliminate the trustee's duty to account. *Hollenbeck v. Hanna,* 802 S.W.2d 412 (Tex. App. - San Antonio, 1991) It is questionable after the *Grizzle* decision that this case is still the law in Texas.

Despite *Grizzle*, it is the author's opinion that modification or elimination of common law fiduciary duties should be governed by the public policy considerations set forth by the courts in judicial opinions. The relationship between the common law public policy restrictions set forth by the courts and the broad language in the Texas Trust Code authorizing modification and/or elimination of fiduciary duties has hopefully not been fully reconciled.

7.3.3 **Power of Trustee to Modify:**

The trustee's power to modify the fiduciary duties imposed upon him or her is very limited. This is obviously because the trustee is the person charged with exercising the fiduciary duties established by the trust instrument and imposed upon him by law.

A trustee may apply to a court of equity pursuant to Tex. Trust Code §115.001 (8) to judicially modify or eliminate one or more of the fiduciary duties imposed upon the trustee.

A Trustee may also apply to a court of equity for instructions or seek a declaratory judgment regarding the exercise of fiduciary duties and the trustee's liability for engaging in an act or omission in the administration of a trust.

Texas courts are reluctant to substitute their discretion for that of a trustee with respect to a routine discretionary decision or to render advisory opinions to a trustee.

A trustee may apply to a court pursuant to Tex. Trust Code §112.054 to judicially modify or eliminate one or more of the fiduciary duties imposed on the trustee.

The author's experience teaches that courts are very reluctant to modify fiduciary duties on the petition of the trustee.

7.3.4 **Power of Beneficiary to Modify**:

The beneficiary's power to vary fiduciary responsibility is generally limited to consenting to a trustee's anticipated act or omission and/or releasing a trustee from a previous act or omission.

7.3.5 **Language Necessary To Modify A Fiduciary Duty:**

7.3.5.1 **General Grant of Powers:** There is a difference between a grant of power to a trustee and the imposition of a duty upon a fiduciary. Consequently, a general grant of powers to a fiduciary should not modify any of the fiduciary duties imposed upon such fiduciary. For example, a provision in an instrument that provides that the trustee "have all of the powers of a fee simple owner" should not waive any of the trustee's fiduciary duties.

> In order to modify a fiduciary duty it should be necessary to refer specifically to the duty that is being modified and to specifically describe the nature and extent of the modification of the duty.

7.3.5.2 **Exculpatory Provisions**: It is the author's opinion that the purpose of an exculpatory clause is to limit a fiduciary's liability for breach of fiduciary duty rather than to modify any fiduciary duty that would otherwise be imposed on the fiduciary. Normally an exculpatory clause merely insulates the trustee from liability that results from breach of fiduciary duty rather than purely equitable remedies such as removal. This issue is discussed in more detail in the specific discussion of exculpatory clauses below. In most cases, language in an exculpatory clause should not modify any fiduciary duty otherwise imposed on the fiduciary.

7.3.6 **A Trustee May Not Be Relieved Of All Fiduciary Duties**: While individual fiduciary duties may be modified, a trustee may not be relieved of all fiduciary duties. The American Law Institute, *Restatement of the Law, Second, Trusts 2d* §25 provides that: "No trust is created unless the settlor manifests an intention to impose enforceable duties." It is possible that he *Grizzle* court will rule, however, that a settlor may relieve a trustee of all fiduciary duties (there are no fiduciary "duties", as distinguished from "powers") that the Texas Trust Code provides cannot be waived.

8 PARTICULAR FIDUCIARY DUTIES:

8.1 THE FIDUCIARY DUTY TO ACCOUNT (AND TO MAINTAIN ACCURATE BOOKS AND RECORDS):

8.1.1 **The Duty**: The trustee is under a duty to the beneficiary to keep and render clear and accurate accounts with respect to the administration of the trust and, upon statutory demand by the beneficiary, to render a written statement of accounts to the beneficiary.

8.1.2 **Commentary:** The trustee has a duty to keep accounts showing in detail the nature and amount of trust property and the administration thereof. If the trustee fails to keep proper accounts, he is liable for any loss or expense resulting from his failure to keep proper accounts. See comments a. and b. to *Restatement, supra* §172.

There is no provision in the Texas Trust Code that requires a trustee to periodically account to a trust beneficiary. Many trust instruments, however, contain provisions requiring the trustee to render periodic accounts to the beneficiaries of the trust. The Texas Trust Code does require that a trustee render a written statement of accounts in response to a statutory accounting demand (made pursuant to Tex. Trust Code §113.151.

Commentary regarding the Texas Statutory Accounting provisions contained in Tex. Trust Code §113.151 and § 113.152:

8.1.2.1 **Tex. Trust Code §113.151 (a)** deals with a **beneficiary's** demand for a statutory written statement of accounts. In order to receive an accounting a trust beneficiary must make a written demand on the trustee to deliver to each beneficiary of the trust the statutory written statement of accounts.

> It is interesting that a beneficiary may not merely seek a statutory written statement of accounts for himself alone, the demand apparently must be on behalf of all beneficiaries of the trust.
>
> If the trustee fails or refuses to deliver the statutory written statement of accounts within 90 days after the date the trustee receives the demand (or after a longer period ordered by a court), any beneficiary (not just the beneficiary who made the demand) may file suit to compel the trustee to deliver the statutory written statement of accounts.
>
> Even though the statute requires that the demand be made on behalf of all beneficiaries of the trust (rather than solely on behalf of the beneficiary making the demand); if a suit to compel is filed, in order to compel the trustee to account to all beneficiaries the court must find that "the nature of the beneficiary's interest in the trust or the effect of the administration of the trust on the beneficiaries interest is sufficient to require an accounting by the trustee."

8.1.2.2 **Tex. Trust Code §113.151 (b)** deals with an "**interested person's**" demand for a statutory written statement of accounts. In order to receive an accounting an "interested person" (such as a creditor, a party to a lawsuit involving the trust, or perhaps the spouse of a beneficiary) must file a lawsuit to compel the trustee to account (rather than simply demand an accounting). If the interested person is successful, then the trustee must account to the interested person (rather than to all of the beneficiaries of the trust).

8.1.3 **Authority:**

8.1.3.1 **The Restatement of Trusts 2d, supra §172**: This section provides that:

> The trustee is under a duty to the beneficiary to keep and render clear and accurate accounts with respect to the administration of the trust.

8.1.3.2 ***Scott, supra*: §172**: provides that:

> A trustee is under a duty to the beneficiaries of the trust to keep clear and accurate accounts. His accounts should show what he has received and what he has expended. They should show what gains have accrued and what losses have been incurred on changes of investments. If the trust is created for beneficiaries in succession, the accounts should show what receipts and what expenditures are allocated to principal and what are allocated to income.

> If the trustee fails to keep proper accounts, all doubts will be resolved against him and not in his favor. The trustee alone is in a position to know all of the facts concerning the administration of the trust, and obviously he cannot be permitted to gain any possible advantage from his failure to keep proper records. Such expenses and costs as may be incurred because of the failure of the trustee to keep proper accounts are not chargeable against the trust estate but are chargeable against the trustee personally. If the trustee fails to keep proper accounts, the court may in its discretion deny him compensation for his services in administering the trust or may decrease the amount of compensation to which he would otherwise be entitled. The neglect of the trustee to keep accounts may be a ground for his removal as trustee...

8.1.3.3 ***Bogert, supra*, §963:** provides that:

> The trustee also owes his beneficiary a duty to render at suitable intervals, upon resignation or removal, and upon termination of the trust, a formal and detailed account of his receipts, disbursements, and property on hand, from which the beneficiary can learn whether the trustee has performed his trust and what the current status of the trust is...

8.1.3.4 **Texas Law:**

8.1.3.4.1 Texas Trust Code §113.151: deals with statutory accounting demands and provides that:

> (a) A beneficiary by written demand may request the trustee to deliver to each beneficiary of the trust a written statement of accounts covering all transactions since the last accounting or since the creation of the trust, whichever is later. If the trustee fails or refuses to deliver the statement on or before the 90th day after the date the trustee receives the demand or after a longer period ordered by a court, any beneficiary of the trust may file suit to compel the trustee to deliver the statement to all beneficiaries of the trust. The court may require the trustee to deliver a written statement of account to all beneficiaries on finding that the nature of the beneficiary's interest is sufficient to require an accounting by the trustee. However, the trustee is not obligated or required to account to the beneficiaries of a trust more frequently than once every 12 months unless a more frequent accounting is required by the court. If a beneficiary is successful in the suit to compel a statement

> under this section, the court may, in its discretion, award all or part of the costs of court and all of the suing beneficiary's reasonable and necessary attorney's fees and costs against the trustee in the trustee's individual capacity or in the trustee's capacity as trustee.
>
> (b) An interested person[2] may file suit to compel the trustee to account to the interested person. The court may require the trustee to deliver a written statement of account to the interested person on finding that the nature of the interest in the trust of, the claim against the trust by, or the effect of the administration of the trust on the interested person is sufficient to require an accounting by the trustee.

8.1.3.4.2 Texas Trust Code §113.152: deals with the contents of a statutory written statement of accounts and provides that:

> A written statement of accounts shall show:
>
> (1) all trust property that has come to the trustee's knowledge or into the trustee's possession and that has not been previously listed or inventoried as property of the trust;
>
> (2) a complete account of receipts, disbursements, and other transactions regarding the trust property for the period covered by the account, including their source and nature, with receipts of principal and income shown separately;
>
> (3) a listing of all property being administered, with an adequate description of each asset;
>
> (4) the cash balance on hand and the name and location of the depository where the balance is kept; and
>
> (5) all known liabilities of the trust.

8.1.3.4.3 Texas Common Law: Prior to the *Grizzle* decision, it was probably against the public policy of the State of Texas for a Settlor to relieve a trustee from his duty to account. See *Hollenbeck v. Hanna,* 802

[2] Tex. Trust Code §111.004 defines an "Interested Person" to mean a trustee, beneficiary, or any other person having an interest in or a claim against the trust or any person who is affected by the administration of the trust. Whether a person, excluding a trustee or named beneficiary, is an interested person may vary from time to time and must be determined according to the particular purposes of and matter involved in any proceeding.

> S.W.2d 412 (Tex. App. - San Antonio, 1991). A trust instrument may impose a duty on the trustee to periodically account to the trust beneficiaries. See *Beaty v. Bales,* 677 S.W.2d 750 (Tex. App. - San Antonio, 1984). A trustee is required to keep full, accurate, and orderly records concerning the status of the trust estate and of all acts performed thereunder. *Shannon v. Frost National Bank,* 533 S.W.2d 389 (Tex. App. - San Antonio, 1975 writ ref'd n.r.e.). Tex. Trust Code Ann. §113.151 and 113.152 grant the beneficiaries the right to obtain a statutory trust accounting from the trustee of the trust."

8.2 **THE FIDUCIARY DUTY TO ADMINISTER THE TRUST**:

8.2.1 **The Duty**: Once a trustee accepts the trust, he must administer it according to its terms, the applicable terms of the Texas Trust Code and the applicable terms of Texas Common Law.

8.2.2 **Commentary:** This is a catchall fiduciary duty that is seldom plead as the basis for recovery in trust litigation.

8.2.3 **Authority:**

8.2.3.1 ***The Restatement of Trusts 2d, supra*: §169**: Provides that:

> Upon acceptance of the trust by the fiduciary he is under a duty to administer the trust.

8.2.3.2 ***Scott, supra*: §169:** provides that:

> If the trustee once accepts the appointment as trustee, he is under a duty to administer the trust as long as he continues to be trustee. We have seen that a trust can be created without notice to or acceptance by the trustee, and that equity will not allow the trust to fail merely because the trustee disclaims. If he has not accepted he can disclaim, and if he does so he is under no liability. But if he has once accepted the trust, he cannot thereafter disclaim; he can resign only with the permission of the court or by the consent of all of the beneficiaries, unless it is otherwise provided by the terms of the trust. The trustee, having accepted, is not relieved of liability merely because by the terms of the trust he is to receive no compensation. His duty to administer the trust is not a contractual duty, and it is immaterial that he receives no consideration for his undertaking to administer the trust.

8.2.3.3 ***Bogert, supra*: §583:** which provides in part that:

> After a trustee has accepted the trust and qualified as required by law of the state in question ... it becomes his duty to carefully examine the terms of the trust and the trust assets in order to determine exactly what property forms the subject-matter of the trust, who are the beneficiaries, and what are the

> trustee's duties with respect to the trust property and the beneficiaries.

8.2.3.4 ***Bogert, supra*: §683:** which provides in part that:

> It is the duty of the trustee to use ordinary, reasonable skill and prudence in following the directions or authority of the settlor with regard to trust investments.

8.2.3.5 **Texas Law:**

Tex. Trust Code §112.009: deals with acceptance of a trust by a trustee and provides, in part, that:

> (a) The signature of the person named as trustee on the writing evidencing the trust or on a separate written acceptance is conclusive evidence that the person accepted the trust. A person named as trustee who exercises power or preforms duties under the trust is presumed to have accepted the trust.

8.2.3.5.1 Tex. Trust Code §113.051: deals with the general duty of a trustee and provides, in part, that:

> The trustee shall administer the trust according to its terms and this subtitle. In the absence of any contrary terms in the trust instrument or contrary provisions of this subtitle, in administering the trust the trustee shall perform all of the duties imposed upon trustees by the common law.

8.2.3.5.2 Texas Trust Code 113.082: Provides for removal of a trustee who has "materially violated or attempted to violate the terms of a trust and the violation results in a material financial loss to the trust."

8.2.3.5.3 Texas Common Law: See *Republic Nat. Bank & Trust Co. v. Bruce*, 105 S.W.2d 882 (Tex. Commission of Appeals, Section B, 1937).

8.3 THE FIDUCIARY DUTY OF CONFIDENTIALITY:

8.3.1 **The Duty**: The trustee has a duty to the beneficiary not to disclose to third persons any information regarding the trust estate that he is administering other than that which is reasonably necessary in connection with the administration of the trust estate.

8.3.2 **Commentary:** While there is no authority specifically identifying this duty, it is the author's opinion that this duty exists.

8.4 THE FIDUCIARY DUTY TO DEFEND ACTIONS:

8.4.1 **The Duty**: The trustee has a duty to the beneficiaries of the trust to defend actions brought against the trust estate of the trust unless, under all circumstances, it is reasonable to make such a defense.

8.4.2 **Commentary:** This duty usually relates a trustee's defense of actions brought against the trust by third parties rather than the trust beneficiaries. If an action is brought by a third person against the trustee and the trustee loses, he is under a duty to the beneficiary to appeal to a higher court, if under all the circumstances it is unreasonable not to appeal (See Comment to *Restatement, supra §178).*

A trustee is obviously acting at risk of breaching this duty any time that the trustee refuses to defend, settles, or compromises a claim brought against the trust. In many of these situations it may be advisable for the trustee to seek prior judicial instruction.

8.4.3 **Authority:**

8.4.3.1 ***The Restatement of Trusts 2d, supra* §178**: provides that:

> The trustee is under a duty to the beneficiary to defend actions which may result in a loss to the trust estate, unless under all the circumstances it is reasonable not to make such defense.

8.4.3.2 ***Scott, supra*: §178:** provides in part that:

> [The trustee] has a certain amount of discretion and is liable only if he abuses the discretion by failing to do what is reasonable under the circumstances. Ordinarily, he should defend actions brought against him that if successful would cause a loss to the trust estate. If he loses in the court below it may be his duty to appeal to a higher court, if under all the circumstances it would be unreasonable not to appeal.

8.4.3.3 ***Bogert, supra* §581:**

> An effort to invalidate or attack a trust may be made in a number of different ways by one or more parties. The settlor himself may seek to set aside the trust conveyance on the ground of fraud, undue influence, duress, or similar reason, or his successors in interest may seek a decree of invalidation for these reasons or because of mental incapacity of the settlor. The creditors of the settlor may attack the trust on the global ground that it was executed in fraud of them. A claim may be made that the trust violates the Rule Against Perpetuities, a mortmain act, or similar statutory or common law rule or policy. The beneficiaries may seek to terminate the trust prematurely. Creditors of a beneficiary may seek to reach the interest of the beneficiary, which may or may not be protected by spendthrift provisions. ... Equity imposes upon the trustee the duty of defending the integrity of the trust if he has reasonable ground for believing that the attack is unjustified or if he is reasonably on doubt on that subject.

8.4.3.4 **Texas Law:**

8.4.3.4.1 Texas Trust Code §113.019: provides that:

> A trustee may compromise, contest, arbitrate, or settle claims of or against the trust estate or the trustee.

Texas Trust Code §114.081 - 114.085: While these sections do not specifically impose this fiduciary duty, they deal with trust actions by and against third parties.

8.5 **THE FIDUCIARY DUTY NOT TO DELEGATE**:

8.5.1 **The Duty**: Under common law, the trustee is under a duty to the beneficiary not to delegate to others the doing of acts which the trustee can reasonably be required to perform. Tex. Trust Code §117.011(a) permits a trustee to delegate "investment and management functions that a prudent trustee of comparable skills could properly delegate under the circumstances," and then sets down the steps the trustee must take to have a proper delegation.

8.5.2 **Commentary:** A trustee may not normally delegate discretionary decisions incident to the trustee's administration of the trust and escape liability for the actions of the delegatee. The statute permits such delegation and relieves the trustee of liability if the trustee follows the statutory procedure. Even without statutory authority, once a trustee makes a discretionary decision, he or she may delegate the implementation of such decision to an agent or employee. A trustee may, also, seek advice from attorneys, accountants, investment advisors, etc. in order to make discretionary decisions.

8.5.3 **Authority (Much of which is modified by statute):**

8.5.3.1 ***The Restatement of Trusts 2d, supra* §171:** provides that:

> The trustee is under a duty to the beneficiary not to delegate to others the doing of acts which the trustee can reasonably be required personally to preform.

8.5.3.2 ***Scott, supra* §171:** provides in part that:

> The trustee clearly cannot transfer to another the whole responsibility for the administration of the trust...If the trustee delegates to another the power to administer the trust, he is personally liable for any loss that results from the negligence or other improper conduct of the person to whom he committed the administration of the trust, but also for any losses resulting form the acts of such person.
>
> Ordinarily a trustee cannot properly organize a corporation to take over the management of the trust property, the trustee taking shares of the corporation in exchange for the property. It is not uncommon, however, where the trust estate consists of a going business or where it includes a

> considerable amount of real estate for the settlor to provide that the trustee may do just this. Where the trustee is given wide powers, they may be interpreted as permitting the formation of such a corporation to take over the administration of the property, on in any event the court may authorize the formation of such corporation.

8.5.3.3 ***Bogert, supra* §555:** which provides in part that:

> If a trustee permits an agent to perform an act which only the trustee acting personally can legally perform, the trustee will be guilty of a breach of trust and the act of the agent under the attempted grant of power will be void.

This section also contains a valuable discussion regarding what powers may and may not be delegated.

8.5.3.4 ***Bogert, supra* §556:** which provides in part that:

> Where the settlor has not authorized the delegation of a particular power and a statute does not grant general delegation authority to the trustee, the trustee's power to delegate a particular power must be determined by the court, in the absence fo a special authorizing statute...

8.5.3.5 **Texas Law:**

8.5.3.5.1 Texas Trust Code: The Texas Trust Code does not contain an express prohibition against delegating authority. Tex. Trust Code §117.011 allows a trustee to delegate investment and management decisions. If the trustee complies with the procedures set forth in this statute, the trustee will not be responsible for the decisions made by an investment agent. Note that Tex. Trust Code §117.011(b) does not relieve the trustee of liability if the delegation is to an affiliate or if the delegation agreement (i) requires arbitration or (ii) shortens the applicable statute of limitations.

8.5.3.5.2 Texas Common Law (Now modified by statute): *Transamerica Leasing Company v. Three Bears, Inc.*, 586 S.W.2d 472 (Tex. 1979) (Dicta: The general rule is that a trustee may not delegate his discretionary power to another. ... A trustee may, however, after determining how to exercise his discretion, give authority to another to carry out ministerial or mechanical acts to effectuate the trustee's decision) See also: *Corpus Christi Bank & Trust v. Roberts,* 587 S.W.2d 173 (Tex. App. – Corpus Christi, 1979);*West v. Hapgood,* 141Tex. 576, 174 S.W.2d 963 (Tex. 1943); and *Grundy v. Broome,* 90 S.W.2d 939 (Tex. App. – Amarillo, 1936).

8.6 **THE FIDUCIARY DUTY TO DISCLOSE**:

8.6.1 **The Duty**: A trustee has two different duties to disclose:

8.6.1.1 **The Duty To Disclose Information Upon Request Of The Beneficiary:** 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 books and records of the trust.

8.6.1.2 **The Duty To Disclose Information In Connection With A Self Dealing Transaction:** If the trustee engages in a self dealing transaction, then the trustee is under a duty to the beneficiary to disclose to the beneficiary all material facts known to the trustee that might affect the beneficiaries rights.

8.6.1.3 **This Section Deals Only With The First Duty:** The duty to disclose in connection with a self dealing transaction is dealt with in the discussion of self dealing transactions set forth below, the remainder of this discussion will deal only with the duty to disclose information on request.

8.6.2 **Commentary:** This is an important and often misunderstood fiduciary duty. In equity, the only person that may enforce the trust and hold the trustee accountable for his actions is the beneficiary. In order to perform these responsibilities the beneficiary must have access to information regarding the administration of the trust. This is a fundamental precept of trust law.

The trustee's duty to disclose exists independently of the TRCP rules of discovery. This duty applies even if no litigious dispute exists between the trustee and the beneficiaries.

The Fiduciary Litigation Paradox (described above) comes into play with respect to the disclosure of information. To the extent that the information sought relates to the trustee's administration of the trust, trust discovery is very different from that in other kinds of litigation which seeks discovery of proprietary information regarding the property of an unrelated third person. Information regarding the administration of the trust is not proprietary information that belongs to the trustee. Although the trust estate is administered by the trustee (who holds legal title for such purpose); the trust estate really belongs to the beneficiaries of the trust (who hold equitable title). The beneficiaries are therefore seeking information about the nature and administration of property that belongs to them rather than the trustee.

Most Texas judges are used to dealing with the disclosure of information solely through the discovery process set forth in the TRCP. Consequently, they often ignore both the trustee's duty to disclose information and the cost to the beneficiary of complying with the TRCP discovery rules and require that all discovery in trust litigation be in compliance with the TRCP discovery rules.

These judges take the position that, prior to the initiation of fiduciary litigation, the equitable disclosure rules apply but after litigation is initiated, the equitable discovery rules are subordinated to the TRCP discovery rules.

This does not appear to be a sound position in the light of the Trust Litigation Paradox, the fact that trust litigation is an equitable (rather than legal) proceeding, the fact that a beneficiary's greatest need for information is in the situation where the beneficiary is actually asserting a cause of action against the trustee and, finally, the fact that information relating to the trust belongs to the beneficiary rather than the trustee.

It is not unusual for a trustee in trust litigation to utilize the cost of numerous expensive discovery hearings and judges reluctance to impose sanctions to prejudice the rights of the plaintiff/beneficiary.

Although not recognized by any Texas Appellate Court, discovery in trust litigation should be bifurcated in the following manner: (1) discovery relating to the nature

and administration of trust property and the inspection of the books and records of the trust should be conducted informally[3] under the rules of equity[4]; and (2) discovery relating to proprietary information that belongs to the trustee individually which should be conducted formally under the TRCP discovery rules.

Examples of the trustee's duty to disclose are:

8.6.2.1 The trustee has a fiduciary duty, without demand to inform all trust beneficiaries of the existence of the trusts. *Bogert, supra*, §961.

8.6.2.2 The trustee has the fiduciary duty, without demand, to inform all trust beneficiaries of the material facts, in connection with any non-routine transaction which significantly affects the trust estate and the interest of the beneficiaries, prior to the transaction taking place. This duty was first recognized by the Washington Supreme Court in *Allard v. Pacific National Bank,* 99 Wash.2d 394, 663 P.2d 104 (1983). This duty was first examined by Texas Courts in *Interfirst Bank v. Risser*, 739 S.W.2d 882, 906 (footnote 28.) (Tex. App. - Texarkana, 1987).

8.6.2.3 The trustee has the fiduciary duty, upon demand by the beneficiary, to inform a beneficiary of the nature and amount of the trust property. *Restatement Of The Law, Trusts 2d,* supra §173; *Scott, supra* §173 and Bogert, *supra,* supra § 961.

8.6.2.4 A Trustee has the fiduciary duty, upon demand by the beneficiary, to inform a beneficiary of the past acts of management of a trustee**.** *Restatement Of The Law, Trusts 2d,* supra §173; *Scott, supra* §173 and Bogert, supra, § 961. There are no Texas Cases specifically dealing with this duty. Authority for the existence of this duty exists in the writings of the commentators set forth above as well in the general recitations contained in *Shannon V. Frost National Bank, supra; Montgomery v. Kennedy, supra; and Huie v. DeShazo, supra.*

8.6.2.5 A Trustee has the fiduciary duty, upon demand by the beneficiary, to inform a beneficiary of the intent of the trustee regarding the future administration of the trust estate. *Restatement Of The Law, Trusts 2d,* supra §173; *Scott, supra* §173 and Bogert, supra § 961. There are no Texas Cases specifically dealing with this duty. Authority for the existence of this duty exists in the writings of the commentators set forth above as well in the general recitations contained in *Shannon V. Frost National Bank, supra; Montgomery v. Kennedy, supra; and Huie v. DeShazo, supra.*

8.6.2.6 A Trustee has the fiduciary duty, upon demand[5], to allow a beneficiary to inspect the books and records of the trust. *Restatement Of The Law, Trusts 2d,* supra §173; *Scott On Trusts, supra* §173 and Bogert, *The Law of Trusts and Trustees,* supra § 961. There are no Texas Cases specifically dealing with this duty. Authority for the existence of this duty exists in the writings of the commentators set forth above as well in the general recitations contained in *Shannon V. Frost National Bank, supra; Montgomery v. Kennedy, supra; and Huie v. DeShazo, supra.*

8.6.3 **Authority:**

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[3] The one exception to this rule should be privileged information between the trustee and his attorney which is not subject to either legal or equitable discovery. *Huie v. DeShazo,* 922 S.W.2d 920 (Tex. 1996)

[4] These rules would only require that a beneficiary make a request to the trustee for the information relating to the trust and, if the trustee failed to comply with the request, file a action to compel the trustee to disclose the information and a judicial determination that the trustee breached his fiduciary duty to disclose (with the consequential equitable remedies).

[5] Demand is made by means of a written demand for information.

8.6.3.1 ***The Restatement of Trusts 2d, supra* §173:** provides that:

> 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.

8.6.3.2 ***Scott, supra*: §173:** provides that:

> The trustee is under a duty to the beneficiaries to give them on their request at reasonable times complete and accurate information as to the administration of the trust. The beneficiaries are entitled to know what the trust property is and how the trustee has dealt with it. They are entitled to examine the trust property and the accounts and vouchers and other documents relating to the trust and its administration. Where a trust is created for several beneficiaries, each of them is entitled to information as to the trust. Where the trust is created in favor of successive beneficiaries, a beneficiary who has a future interest under the trust, as well as a beneficiary who is presently entitle to receive income, is entitled to such information, whether his interest is vested or contingent.

8.6.3.3 ***Bogert, supra* § 961:** provides that:

> The beneficiary is the equitable owner of the trust property, in whole or in part. The trustee is the mere representative whose function is to attend to the safety of the trust property and to obtain its avails for the beneficiary in the manner provided by the trust instrument. That the settlor has created a trust and thus required that the beneficiary enjoy his property interest indirectly does not imply that the beneficiary is to be kept in ignorance of the trust, the nature of the trust property and the details of its administration. If the beneficiary is to be able to hold the trustee to proper standards of care and honesty and to obtain the benefits to which the trust instrument and doctrines or equity entitle him, he must know what the trust property consists and how it is being managed.
>
> From these considerations it follows that the trustee has the duty to inform the beneficiary of important matters concerning the trust and that the beneficiary is entitled to demand of the trustee all information about the trust and its execution for which he has any reasonable use. It further follows that the trustee is under a duty to notify the beneficiary of the existence of the trust so that he may exercise his rights to secure information about trust matters and

> to compel an accounting from the trustee. For the reason that only the beneficiary has the right and power to enforce the trust and to require the trustee to carry out the trust for the sole benefit of the beneficiary, the trustee's denial of the beneficiary's right to information consists of a breach of trust.
>
> If the beneficiary asks for relevant information about the terms of the trust, its present status, past acts of management, the intent of the trustee as to future administration, or other incidents of the administration of the trust, and these requests are made at a reasonable time and place and not merely vexatiously, it is the duty of the trustee to give the beneficiary the information which he is asked. Furthermore, the trustee must permit the beneficiary to examine the account books of the trust, trust documents and papers, and trust property, when a demand is made at a reasonable time and place and such inspection would be of benefit to the beneficiary...
>
> The court will order a trustee to give information to the beneficiary when the trustee has unreasonably refused, and in such case the trustee must personally bear the cost of such a proceeding....

8.6.3.4 **Texas Law:**

8.6.3.4.1 Texas Trust Code: (Other than the Accounting provisions discussed above) there is no Texas Trust Code provision specifically dealing with the duty to disclose information.

8.6.3.4.2 Texas Common Law:

8.6.3.4.2 1 In *Shannon V. Frost National Bank,* 533 S.W.2d 389 (Tex. App. - San Antonio, 1975, writ ref'd n.r.e.), the court held that:

> However, it is well settled that a trustee owes a duty to give to the beneficiary upon request complete and accurate information as to the administration of the trust. 2 Scott, Trusts §173 (3rd. ed. 1967).

8.6.3.4.2 2 In *Montgomery v. Kennedy,* 669 S.W.2d 309 (Tex. 1984) the Texas Supreme Court held that:

> As trustees of a trust and executors of an estate with Virginia Lou as a beneficiary, Jack Jr. and his mother owed Virginia Lou a fiduciary duty of full disclosure of all material facts known to them that might affect Virginia Lou's rights....The existence of strained relations

> between the parties did not lessen the fiduciary's duty of full and complete disclosure..... The concealment of a material fact by a fiduciary charged with the duty of full disclosure is extrinsic fraud.

8.6.3.4.2 3 In *Huie v. DeShazo*, 922 S.W.2d 920 (Tex. 1996) the Texas Supreme Court observed that:

> Trustees and executors owe beneficiaries "a fiduciary duty of full disclosure of all material facts known by them that might affect [the beneficiaries] rights. *Montgomery v. Kennedy*, 669 S.W.2d 309, 313 (Tex. 1984). See also TEX. PROB. CODE §113.151(a) (requiring trustee to account to beneficiaries for all trust transactions.) **This duty exists independently of the rules of discovery, applying even if no litigious dispute exists between the trustee and beneficiaries...** (emphasis supplied)

8.7 **THE FIDUCIARY DUTY TO ENFORCE CLAIMS**:

8.7.1 **The Duty**: The trustee has a duty to the beneficiary to take reasonable steps in connection with the prosecution of claims and causes of action that the trust has against third persons.

8.7.2 **Commentary:** This duty also relates to claims and causes or action that the trustee has against prior trustees, and in connection with testamentary trusts, against executors, and persons conveying assets to the trust estate of the trust. If a person commits a tort with respect to the trust estate, it is the duty of the trustee to take reasonable steps to compel him to redress the tort. See comments to *Restatement, supra* §177.

If an action is brought by the trustee and the trustee loses, he is under a duty to the beneficiary to appeal to a higher court, if under all the circumstances it is unreasonable not to appeal. See comments to *Restatement, supra* §177.

A trustee is obviously acting at risk of breaching this duty any time that the trustee refuses to prosecute, settles, or compromises a claim or cause of action that he has against a third party. In many of these situations it may be advisable for the trustee to seek prior judicial instruction.

8.7.3 **Authority:**

8.7.3.1 ***The Restatement of Trusts 2d, supra*: §177:** provides that:

> The trustee is under a duty to the beneficiary to take reasonable steps to realize on claims which he holds in trust.

8.7.3.2 ***Scott, supra* §177:** provides in part that:

> A trustee is under a duty to the beneficiaries to take reasonable steps to realize on claims he holds in trust. If he fails to take such steps as are reasonable he is subject to a surcharge for such loss as results from his failure to act. Where the claim could have been collected in full if he had taken proper proceedings to collect it, and because of his delay the claim has become uncollectible, he is subject to a surcharge for the full amount of the claim and interest thereon...

8.7.3.3 ***Bogert, supra* §592:** provides in part that:

> As part of the process of assuming control of the trust property, the trustee has the duty of collecting choses in action which are a prat of the trust estate. If he finds notes, bonds, mortgages, checks, drafts, judgments, or other contract or tort claims among the trust assets, he should proceed with reasonable diligence to collect as much money as possible from the obligors. For failure to collect with reasonable skill and celerity, the trustee will be liable.

8.7.3.4 **Texas Law:**

8.7.3.4.1 Texas Trust Code: While authorized by common law, there does not appear to be a specific provision in the Texas Trust Code specifically imposing a duty on the trustee to prosecute claims and causes of action on behalf of the trust estate. See, however, Tex. Trust Code §113.019 which gives the trustee the power to: "compromise, contest, arbitrate, or settle claims of or against the trust estate or the trustee".

8.7.3.4.2 Texas Common Law: See: *Cogdell v. Fort Worth Nat. Bank*, 544 S.W.2d 825 (Tex. Civ. App. – Eastland, Dec. 09, 1976)

8.8 THE FIDUCIARY DUTY OF GOOD FAITH AND FAIR PLAY:

8.8.1 **The Duty**: The trustee is under a duty to act in good faith in his administration of the trust. If the trustee engages in a transaction with one or more of the beneficiaries of the trust then the courts will impose a duty of the utmost good faith and fair play. See the commentary on self dealing below.

8.8.2 **Commentary:** This duty is so fundamental that there is very little statutory or common law dealing with its general application. There is, of course, extensive common law dealing with this duty in the context of self-dealing transactions.

8.8.3 **Authority:**

8.8.3.1 ***The Restatement of Trusts 2d, supra***: There is no provision specifically dealing with this duty.

8.8.3.2 ***Scott, supra*:** There is no provision specifically dealing with this duty.

8.8.3.3 **Bogert, supra §544:**

> In all matters connected with his trust, a trustee is bound to act in the highest good faith towards his beneficiary, and may not obtain any advantage therein over the later by the slightest misrepresentation, concealment, threat, or adverse pressure of any kind. A trustee may not use the influence which his position gives him to obtain any advantage from his beneficiary.

8.8.3.4 **Texas Law:**

8.8.3.4.1 Texas Trust Code: There is no provision specifically dealing with this duty.

8.8.3.4.2 Texas Common Law: The court in *Herschbach v. City of Corpus Christi,* 883 S.W.2d 720, 735 (Tex. App. – Corpus Christi 1994) held that:

> A trustee owes a trust beneficiary an unwavering duty of good faith, fair dealing, loyalty and fidelity over the trust's affairs and its corpus. *Ames v. Ames,* 757 S.W.2d 468, 476 (Tex. App. - Beaumont 1988), aff'd and modified, 776 S.W.2d 154 (Tex. 1989), cert. denied, 494 U.S. 1080, 110 S.Ct. 1809, 108 L.Ed.2d (1990)

See the discussion of self-dealing below. Also see *Geeslin v. McElhenney,* 788 S.W.2d 683 (Tex. App. - Austin, no writ.) dealing with an executor's duty to protect the beneficiaries' interest by fair dealing in good faith with fidelity and integrity. See also: *Murphy-Bolanz Land & Loan Co. v McKibben*, 236 SW 78; *Hendricks v. Wall*, 277 SW 207; *Spencer v Pettit*, 17 S.W.2d 1102; *Shannon v. Frost National Bank*, 533 S.W.2d 389, (Tex. Civ. App. – San Antonio, 1975, writ ref'd n.r.e.); *InterFirst Bank Dallas, N.A. v. Risser*, 739 S.W.2d 882 (Tex. Civ. App. – Texarkana, 1987).

8.9 THE FIDUCIARY DUTY OF IMPARTIALITY:

8.9.1 **The Duty**: The trustee has a duty to deal impartially with both multiple beneficiaries within a class and with multiple classes of beneficiaries. The duty has now been codified in Tex. Trust Code §117.008.

8.9.2 **Commentary:** If there is more than one income beneficiary then, In the absence of provisions in the trust instrument waiving or modifying this duty, the trustee must act impartially in the distribution of income among them, taking into account any differing interests of the beneficiaries.

In the absence of provisions in the trust instrument waiving or modifying this duty, the trustee must act impartially in the administration of the trust between income beneficiaries and remaindermen.

If the distribution standard is purely discretionary the trustee may be relieved of this duty and the courts will not control the exercise of such discretion except to prevent the trustee from abusing it.

Many discretionary decisions involve the fiduciary duty of impartiality. Some examples are:

8.9.2.1 **Investment Decisions**. The decision to invest in assets for the purpose of generating either income or growth involves the fiduciary duty of impartiality. Under the Prudent Investor Rule, the trustee has several factors to consider, but the old automatic dichotomy between income oriented investments favoring the income beneficiary and growth oriented investments favoring the remainderman is modified. Instead the trustee is urged to diversify (Tex. Trust Code §117.005) and to invest for overall return (Tex. Trust Code §117.004), and is given a power to reallocate between income and principal to achieve impartiality (Tex. Trust Code §116.005).

8.9.2.2 **Allocation of Receipts and Disbursements**. Each discretionary allocation of receipts and disbursements involves the fiduciary duty of impartiality. If a receipt or disbursement is allocated to the income account then the allocation will affect the income beneficiary. If a receipt or disbursement is allocated to the principal account then the allocation will affect the remainderman.

8.9.2.3 **Reserves for Depreciation or Depletion**. Whether to establish a reserve as well as the amount of the reserve will involve the fiduciary duty of impartiality. (Tex. Trust Code §§116.174 [depletion] and 116.203 [depreciation])

8.9.2.4 **Accumulation of Income.** Whether to accumulate or distribute income may involve the fiduciary duty of impartiality. This is especially true if accumulated income becomes part of the principal account.

8.9.2.5 **Discretionary Income Distributions.** The amount of income distributed under a discretionary income distribution standard may involve the fiduciary duty of impartiality.

8.9.2.6 **Invasion of Corpus.** Whether or not to invade the principal of the trust may involve the fiduciary duty of impartiality.

8.9.3 **Authority:**

8.9.3.1 ***The Restatement of Trusts 2d, supra* §183:** provides that:

> When there are two or more beneficiaries of a trust the trustee is under a duty to deal impartially with them.

8.9.3.2 ***Scott, supra* §183:** provides in part that:

> Ordinarily, a trust is created for more than a single beneficiary. In such case it is the duty of the trustee to deal impartially as among the several beneficiaries. By the terms of the trust the trustee may have discretion to favor one beneficiary over another, the extent of this discretion depending on the provisions of the instrument...
>
> Ordinarily, the question of the duty of impartiality of the trustee arises where there are successive beneficiaries, some being entitled to the income, others being ultimately entitled to the principal...The question of the duty of impartiality

of the trustee may arise, however, with respect to simultaneous as well as successive beneficiaries, that is, with respect to several beneficiaries who are entitled to share in the income, or several beneficiaries who are entitled to share in the principal.

8.9.3.3 ***Bogert, supra* §541:** provides in part that:

> A trustee who holds for successive beneficiaries owes a duty to them to administer the trusts with impartial consideration for the interests of all the beneficiaries. He should not unnecessarily show a preference either for the current beneficiaries or for the remaindermen who may be or become entitled to the principal at a future date. In making investments and sales, disposing of receipts, paying expenses, and making other decisions, the trustee should endeavor to act in such a way that a fair result is reached with regard to the interests of the current or income beneficiaries and those who take possession of their interests at a subsequent date.

8.9.3.4 **Texas Law:**

8.9.3.4.1 Texas Trust Code §116.004: which provides that:

> (a) In allocating to or between principal and income..., a fiduciary:
>
> > (1) shall administer a trust or estate in accordance with the terms of the trust or the will, even if there is a different provision in this chapter;...
> >
> > (3) shall administer a trust or estate in accordance with this chapter if the terms of the trust or the will do not contain a different provision or do not give the fiduciary a discretionary power of administration; and
> > (4) shall add a receipt or charge a disbursement to principal to the extent that the terms of the trust and this chapter do not provide a rule for allocating the receipt or disbursement to or between principal and income. (Note that this is a change from the former Texas rule which required an equitable allocation.)
>
> (b) In exercising the power to adjust under Section 116.005(a) or a discretionary power of administration regarding a matter within

> the scope of this chapter, whether granted by the terms of a trust, a will or this chapter, a fiduciary shall administer a trust or estate impartially, based on what is fair and reasonable to all of the beneficiaries, except to the extent that the terms of the trust or the will clearly manifest an intention that the fiduciary shall or may favor one or more of the beneficiaries. A determination in accordance with the this chapter is presumed to be fair and reasonable to all the beneficiaries.

8.9.3.4.2 Texas Common Law: See *Commercial Nat. Bank of Nacogdoches v. Hayter,* 473 S.W.2d 561 (Tex. Civ. App. 1968, *writ ref'd n.r.e.)*

8.10 **THE FIDUCIARY DUTY TO KEEP TRUST PROPERTY SEPARATE (AND NOT TO COMMINGLE)**:

8.10.1 **The Duty**: It is ordinary the duty of the trustee to keep the trust estate of the trust separate from his personal property and from other property that he administers.

8.10.2 **Commentary:** Ordinarily it is the duty of the trustee (1) to keep the trust property separate from his own property; (2) to keep the trust property separate from property he administers as the trust estate of other trusts; and (3) to earmark the trust property as property of the trust. See comment to *Restatement §*179.

Texas has special rules dealing with the commingling of trust assets. The Texas rule is that where a trustee wrongfully mixes trust funds of an indeterminable amount with his own private funds, the burden is on him to distinguish his funds and the amount thereof from those of the beneficiaries of the trust; and if he can not do so the whole commingled fund, or the property purchased therewith, becomes subject to a constructive trust in favor of the beneficiaries of the trust.

8.10.3 **Authority:**

8.10.3.1 **The *Restatement of Trusts 2d, supra* §179:** provides that:

> The trustee is under a duty to the beneficiary to keep the trust property separate from his individual property, and so far as it is reasonable that he should do so, to keep it separate from other property not subject to trust and to see that the property is designated as property of the trust.

8.10.3.2 ***Scott, supra* §179:** provides in part that:

> It is the duty of a trustee to keep the trust property separate from other property and properly to designate it as property of the trust. It is his duty:
>
> (1) to keep the trust property separate from his own property;

> (2) to keep the trust property separate from property held upon other trusts; and
>
> (3) to designate trust property as property of the trust.

8.10.3.3 ***Bogert, supra* §596 - 612:** provides in part that:

> The fundamental idea of the trust is equitable ownership in specific and definite property, tangible or intangible. If the trust property is not identified by the trustee, great difficulties are placed in the way of the beneficiary if he is obliged to go into equity to get enforcement...

8.10.3.4 **Texas Law:**

8.10.3.4.1 Texas Trust Code: There is not statutory duty to segregate that specifically applies to trustees.

8.10.3.4.2 Texas Common Law: *Andrews v. Brown,* 10 S.W.2d 707 (Com. App. 1928); *Logan v. Logan*, 156 S.W.2d 507 (Tex. 1941); *Eaton v. Hasted*, 172 S.W2d 493 (Tex. 1943); *Lung v. Lung*, 259 S.W.2d 253 (Tex. 1953); *General Association of Davidian Seventh Day Adventists, Inc. v. General Association of Davidian Seventh Day Adventists,* 410 S.W.2d 256 (Tex. Civ. App. - Waco 1956; *writ ref'd n.r.e.*); and *Pierce v. Sheldon Petroleum Co.*, 589 S.W.2d 849 (Tex. Civ. App. - Amarillo, no writ)

8.11 THE FIDUCIARY DUTY OF LOYALTY:

8.11.1 **The Duty**: The trustee must display complete loyalty to the interests of the beneficiary and must exclude all selfish interests and all consideration of the interests of third persons.

8.11.2 **Commentary:** The fiduciary duty of loyalty and self dealing are entwined. If a trustee breaches his fiduciary duty of loyalty in a manner that benefits himself personally then he has engaged in self dealing. Self dealing is dealt with separately below.

8.11.3 **Authority:**

8.11.3.1 ***The Restatement of Trusts 2d, supra* §170 (1):** provides that:

> The trustee is under a duty to the beneficiary to administer the trust solely in the interest of the beneficiary.

8.11.3.2 ***Scott, supra* §170:**

> The most fundamental duty owed by the trustee to the beneficiaries of the trust is the duty of loyalty. This duty is imposed on the trustee not because of any provision in the terms of the trust but because of the relationship that arises from the creation of the trust. A trustee is in a fiduciary relation to the beneficiaries of the trust. ... It is the duty of the trustee to administer the trust solely in the interest

of the beneficiaries. He is not permitted to place himself in a position where it would be for his own benefit to violate his duty to the beneficiaries.

8.11.3.3 ***Bogert, supra* §543:**

Perhaps the most fundamental duty of a trustee is that he must display throughout the administration of the trust complete loyalty to the interests of the beneficiary and must exclude all selfish interest and all consideration of the interests of third persons.

A distinguished jurist has expressed this concept in classic language: "Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the 'disintegrating erosion' of particular exceptions. Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd."

A trustee's duty of loyalty has been described as inherent in the trust relationship. This duty is sometimes stated as the rule of undivided loyalty, or simply the loyalty rule. Though sometimes it has been difficult for the courts to determine whether the rule should be applied under the circumstances of the particular case, nevertheless the loyalty rule may be simply stated:

> A trustee is under a duty to the beneficiary of the trust to administer the trust solely in the interest of the beneficiary. The trustee must exclude all self-interest, as well as the interest of a third party, in his administration of the trust solely for the benefit of the beneficiary. The trustee must not place himself in a position where his own interests of that of another enters into conflict, or may possibly conflict with the interest of the trust or its beneficiary. Put another way, the trustee may not enter into a transaction or take or continue in a position in which his personal interest or the interest of a third

party is or becomes adverse to the interest of the beneficiary.

Self-dealing by the trustee is but one type of conflict of interest. It is prohibited because there is an obvious conflict between the individual interest of the trustee and the interest of the trust and its beneficiary in the transaction involving trust property. This conflict prevents the trustee from exercising an independent and disinterested judgment on behalf of the trust. For example, a trustee may not sell or lease trust property, or lend trust funds to himself as an individual, and may not acquire from a third party, for himself as an individual, any interest in trust property, such as an encumbrance on trust property or the renewal of a lease of trust property in his individual name. Similarly, a trustee may not sell or lease his individual property or his services to himself as trustee, and a corporate trustee may not retain or acquire its own stock as a trust investment. Moreover, a trustee may not acquire for himself, individually, property which should be acquired for the trust, nor may he engage, as an individual, in activities which compete with those he conducts as trustee. In any direct transaction or dealing with the beneficiary a trustee must deal fairly and disclose all relevant facts. The rule against self-dealing extends to transactions with a firm of which the trustee is a member, a corporation in which he has a controlling or substantial interest, and with a spouse, agents, employees and other persons whose interests are closely identified with those of the trustee.

Other types of conflicts of interest do not involve self-dealing but are deemed to impair the trustee's independent and disinterested judgment in the administration of the trust.

8.11.3.4 **Texas Law:**

8.11.3.4.1 **Texas Trust Code** : The Texas Trust Code codifies the duty of loyalty in Tex. Trust Code §117.007 as, "A trustee shall invest and manage the trust assets solely in the interest of the beneficiaries.

8.12 **SELF DEALING**:

8.12.1 **The Duty**: The trustee may not exercise his discretion in connection with the administration of the trust in a manner that benefits himself personally.

8.12.2 **Commentary**: The duty of fidelity required of a trustee forbids the trustee from placing itself in a situation where there is or could be a conflict between its self interest and its duty to the beneficiaries. See *InterFirst Bank Dallas v. Risser, supra*, at 899; *Slay v. Burnett Trust*, 143 Tex. 621, 187 S.W.2d 377, 387 (Tex. 1945); *Kinney v. Shugart*, 234 S.W.2d 451, 452 (Tex. Civ. App. -- Eastland 1950, writ ref'd).

Courts have gone to great ends to protect the object of a fiduciary obligation. As the *Slay* court observed:

> Trustees cannot make a profit from the trust funds committed to them, by using the money in any kind of trade or speculation, nor in their own business . In all such cases, the trustees must account for every dollar received from the use of the trust-money and they will be **absolutely responsible** for it if it is lost in any such transactions. * * *
>
> By this rule trustees may be liable to great losses while they can receive no profit; and the rule is made thus stringent . . .
>
> These matters, intent to defraud and conspiracy and injury or damage to the beneficiary, are **immaterial to the determination of liability in this case**. . . It is well settled that in a suit of this kind recovery may be had by the beneficiary **even though he has suffered no damages and even though the trustee may have acted in good faith.** (emphasis added).

Justice Cardozo perhaps best expressed the rule regarding conduct of a fiduciary and the unbending attitude of the courts in supporting that rule:

> Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of the courts of equity when petitioned to undermine the rule of undivided loyalty by the 'disintegrating erosion' of particular exceptions. * * * Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd. It will not consciously be lowered by any judgment of this court.

Langford v. Shamburger, 417 S.W.2d 438, 443 (Tex. Civ. App.--Ft. Worth 1967, writ ref'd n.r.e.) citing *Meinhard v. Salmon*, 249 N.Y. 458, 164 N.E. 545-546, 62 A.L.R. 1 (1928).

The court in *Risser, supra* at 897 defined "self dealing to mean:

> Any type of activity by the trustee which gives the trustee an advantage to the detriment of the beneficiaries could be construed as self-dealing. This would not include the trustee's right to reasonable compensation, nor should it include an activity not prohibited by statute in which the trustee does not use his position as trustee to gain such an advantage.
>
> The earlier Texas trust cases involving breaches of fiduciary duty did not use the term *self-dealing;* nor did the cases make a clear distinction between self interest, which was a statutory violation, as opposed to a conflict of interest

situation. For example, the acts involved in *Slay v. Burnett Trust, supra* seem to involve both a statutory violation and a conflict of interest, but the court did not draw any distinction between the two activities.

Perhaps it would be simpler if all Texas cases divided themselves into a neat dichotomy of those which involve statutory self-dealing and those which involve conflicts of interest not covered by statute. However, such a clear division of terms does not exist in the case law. It has been suggested that it would be helpful to the courts to determine what is self-dealing and what is a conflict of interest but not self dealing, so that the courts could then assess whether the danger of permitting the trustee to engage in the action must be so great as to make the action wholly impermissible or only such as to make the action permissible if justifiable...

Thus in a broad sense, self-dealing and the duty of loyalty are entwined to require the trustee to forego his own personal interest and opportunities for gain with respect to property subject to the fiduciary relationship and to act completely in the interest of the beneficiaries of the relationship.

Attempted Self-dealing: A trustee may be held liable for self-dealing even if the transaction was never consummated. In Yturri v. Yturri, 504 S.W.2d 809 (Tex. Civ. App. - San Antonio, 1973) the court observed that:"We know of no authority which supports the contention that a fiduciary's attempt at self-dealing is purified because his scheme was discovered and frustrated."

Types of Self-dealing: There appear therefore to be two types of self dealing. Rather than refer to them as "self dealing" and "conflict of interest", this author refers to them as "statutory self-dealing" and "common law self-dealing".

Statutory Self-dealing: Tex. Trust Code §113.052 (Loan of Trust Funds To Trustee), §113.053 (Purchase of Sale of Trust Property by Trustee), §113.054 (Sales From One Trust To Another) and §113.055 (Purchase of Trustee's Securities) contain the statutory self dealing prohibitions.

Statutory Self-dealing requires strict liability. Once it is established that statutory self-dealing has occurred the trustee is then strictly liable, or as the *Risser* Court observed:

> Once it had been established that there was [statutory] self-dealing, the no-further-inquiry rule came into play. This rule essentially said that good faith and fairness were not enough to save the trustee from liability if the trustee has engaged in [statutory] self dealing.

Common Law Self-dealing: If a trustee takes any discretionary action which directly or indirectly benefits the trustee (or the trustee's family or affiliates) to the detriment of the beneficiaries, then the transaction is presumed fraudulent under Texas Law. This

is the so called "Constructive Fraud" rule. The burden of proof then shifts to the fiduciary to provide that the transaction is "fair" to the beneficiaries of the trust.

Fairness has been held to be one proper for jury determination. *Miller v. Miller* 700 S.W.2d 941 (Tex. App. - Dallas 1985)

The trustee must show that the transaction is "fair, honest and equitable." *Archer, supra,* at 740.

In establishing the fairness of a transaction, some of the most important factors are:

1. Whether the trustee made a full disclosure,

2. Whether the consideration is adequate;

3. Whether the beneficiary had the benefit of independent advice; and

4. Whether the trustee has benefitted or profited from the transaction at the expense of the beneficiary.

Miller, supra at 946; *Bogert, supra* §544; *Gaynier v. Ginsberg*, 715 S.W.2d 749 (Tex. App. - Dallas, 1986).

Perhaps the most important factor set forth above is that of full disclosure. This duty requires the trustee without demand, to disclose all relevant information relating to any transaction in which the trustee has a personal interest. Archer v. Griffith, 390 S.W.2d 735 (Tex. 1964);*Restatement Of The Law, Trusts 2d,* supra §170; *Scott On Trusts, supra* §170 and Bogert, *The Law of Trusts and Trustees,* supra § 543. A lead Texas case on this issue is *Kinzbach Tool Co. v. Corbett-Wallace Corporation,* 160 S.W.2d 509 (Tex. 1942). See also *Gaynier v. Ginsberg,* 715 S.W.2d 749 (Tex. App.-Dallas, 1986); *Gaynier v. Ginsberg,* 715 S.W.2d 749 (Tex. App.-Dallas 1986); *Miller v. Miller,* 700 S.W.2d 941 (Tex. App.-Dallas 1985); *Johnson v. Peckham,* 120 S.W.2d 786 (Tex. 1938

In any transaction wherein a person benefitting from it stands in a fiduciary relationship to one or more of the other parties, the transaction, if challenged, is presumed by equity to be unfair and, therefore, a constructive fraud unless the fairness of the transaction is proven by the benefitting fiduciary. *Stephens County Museum, Inc. v. Swenson,* 517 S.W.2d 257, 260 (Tex. 1974).
Unlike actual fraud, constructive fraud does not necessarily involve dishonesty of purpose or an intent to deceive and, therefore, proof of such is not required in order to invoke the doctrine. *Archer v. Griffith,* 390 S.W.2d 735, 740 (Tex. 1964).

Thus, once a plaintiff establishes that the transaction which he wishes to avoid was executed while a fiduciary relationship existed between him and the defendant, the burden of presenting evidence and securing a finding that the transaction was fair to the plaintiff is put upon the defendant fiduciary who claims the validity and benefits from the transaction. *Ginther v. Taub,* 570 S.W.2d 516, 525

(Tex. Civ. App.--Waco 1975, writ ref'd n.r.e.); *Gaynier v. Ginsberg,* 715 S.W.2d 749,754 (Tex. App.--Dallas 1986, writ ref'd n.r.e.). Evidence introduced by the defendant to meet this burden simply creates a question of fact. *Ginther,* 570 S.W.2d at 525.

Absent any such proof, the presumption of unfairness and constructive fraud stands unrebutted, and the transaction is invalid as a matter of law. *Texas Bank and Trust v. A. E. Moore*, 595 S.W.2d 502 (Tex. 1980). Because the burden of proof in this cause of action is shifted to the defendant, it is distinguishable from other types of "constructive fraud" in which the entire burden rests on the party asserting it. *Miller v. Miller,* 700 S.W.2d 941 (Tex. App.--Dallas 1985, writ ref'd n.r.e.).

It is clear that under Texas law a plaintiff is not required to show that he relied upon the defendant to discharge his fiduciary duties in order to assert a claim of constructive fraud successfully. *Johnson v. Peckham,* 120 S.W.2d 786, at 788 (Tex. 1936). In *Johnson*, the court held that the trial court had not erred in refusing to submit a special issue to the jury which called upon it to determine whether or not the plaintiff had relied upon his partner to make certain disclosures to him concerning negotiations for the sale of partnership property. As the court noted, a fiduciary is under an absolute duty to carry out the responsibilities of his position and, therefore, reliance by the plaintiff is not necessary to establish constructive fraud.

See Carl David Adams, *Benefitting From Fiduciary Office: A Presumption of Fraud,* 47 Tex. B.J. 648 (1984).

Damages: A beneficiary can attack a self-dealing transaction even though he has suffered no damage and the trustee has acted in good faith. See *Harvey v. Casebeer,* 531S.W.2d 206 (Tex. Civ. App. - Tyler 1975, no writ) See also [although the distinction between statutory and common law self-dealing was not address or recognized in this case] *Slay v. Burnett Trust*, 187 S.W.2d 377 (Tex. 1945)(These matters, intent to defraud and conspiracy and injury of damage to the beneficiary are immaterial in the determination of liability in this case...It is well settled that in a suit of this kind recovery may be had by the beneficiary even though he has suffered no damages and even though the trustee may have acted in good faith.)

8.12.3 **Authority:**

8.12.3.1 **Restatement of Trusts 2d, supra §170 (2):** provides that:

> The trustee in dealing with the beneficiary on the trustee's own account is under a duty to the beneficiary to deal fairly with him and to communicate to him all material facts in connection with the transaction which the trustee knows or should know.

8.12.3.2 ***Scott, supra* §170**:

The most fundamental duty owed by the trustee to the beneficiaries of the trust is the duty of loyalty. This duty is imposed on the trustee not because of any provision in the terms of the trust but because of the relationship that arises from the creation of the trust. A trustee is in a fiduciary relation to the beneficiaries of the trust. There are other fiduciaries, such as guardians, executors or administrators, receivers, agents, attorneys, corporate directors or officers, partners, and joint adventurers. In some relations the fiduciary element is more intense than in others; it is peculiarly intense in the case of a trust. It is the duty of the trustee to administer the trust solely in the interest of the beneficiaries. He is not permitted to place himself in a position where it would be for his own benefit to violate his duty to the beneficiaries.

8.12.3.3 ***Bogert, supra* §543:**

8.12.3.4 **Texas Law:**

8.12.3.4.1 Texas Trust Code §113.052: provides that:

(a) Except as provided by Subsection (b) of this section, a trustee may not lend trust funds to:

(1) the trustee or an affiliate;
(2) a director, officer, or employee of the trustee or an affiliate;

(3) a relative of the trustee; or

(4) the trustee's employer, employee, partner, or other business associate.

(b) This section does not prohibit:

(1) a loan by a trustee to a beneficiary of the trust if the loan is expressly authorized or directed by the instrument or transaction establishing the trust; or
(2) a deposit by a corporate trustee with itself under Section 113.057 of this Act.

8.12.3.4.2 Texas Trust Code § 113.053: provides that:

(a) Except as provided by Subsections (b), (c), (d), (e), and (f) a trustee shall not directly or indirectly buy or sell trust property from or to:

(1) the trustee or an affiliate;

(2) a director, officer, or employee of the trustee or an affiliate;

(3) a relative of the trustee; or

(4) the trustee's employer, partner, or other business associate.

(b) A national banking association or a state-chartered corporation with the right to exercise trust powers that is serving as executor, administrator, guardian, trustee, or receiver may sell shares of its own capital stock held by it for an estate to one or more of its officers or directors if a court:

(1) finds that the sale is in the best interest of the estate that owns the shares;

(2) fixes or approves the sales price of the shares and the other terms of the sale; and

(3) enters an order authorizing and directing the sale.

(c) If a corporate trustee, executor, administrator, or guardian is legally authorized to retain its own capital stock in trust, the trustee may exercise rights to purchase its own stock if increases in the stock are offered pro rata to shareholders.

(d) If the exercise of rights or the receipt of a stock dividend results in a fractional share holding and the acquisition meets the investment standard required by this subchapter, the trustee may purchase additional fractional shares to round out the holding to a full share.

(e) A trustee may:

(1) comply with the terms of a written executory contract signed by the settlor, including a contract for deed, earnest money contract, buy/sell agreement, or stock purchase or redemption agreement; and

(2) sell the stock, bonds, obligations, or other securities of a corporation to the issuing corporation or to its corporate affiliate if the sale is made under an agreement described in Subdivision 91) or complies with the duties imposed by Chapter 117.

(f) A national banking association, a state-chartered corporation, including a state-chartered bank or trust company, a state or federal savings and loan association that has the right to exercise trust powers and that is serving as trustee, or such an institution that is serving as custodian with respect to an individual retirement account, as defined by Section 408, Internal Revenue Code, or an employee benefit plan, as defined by Section 9(3), Employee section 1002(3), regardless of whether the custodial account is, or would otherwise be, considered a trust for purposes of this subtitle, may:

> (1) employ an affiliate or division within a financial institution to provide brokerage, investment, administrative, custodial, or other account services for the trust or custodial account and charge the trust or custodial account for the services, provided, however, nothing in this section shall allow an affiliate or division to engage in the sale or business of insurance if not otherwise permitted to do so; and
>
> (2) receive compensation, directly or indirectly, on account of the services performed by the affiliate or division within the financial institution, whether in the form of shared commissions, fees, or otherwise, provided that any amount charged by the affiliate or division for the services is disclosed and does not exceed the customary or prevailing amount that is charged by the affiliate or division, or a comparable entity, for comparable services rendered to a person other than the trust.

(g) In addition to other investments authorized by law for the investment of funds held by a fiduciary or by the instrument governing the fiduciary relationship, and notwithstanding any other provision of law and subject to the standard contained in Chapter 117, a bank or trust company acting as a fiduciary, agent, or otherwise, in the exercise of its investment discretion or at the direction of another person authorized to direct investments of funds held by the bank or trust company as a fiduciary, may invest and reinvest in the securities of an open-end or closed-end management investment company or investment trust registered under the Investment Company Act of 1940 (15 U.S.C. 80a-1 et seq.) If the portfolio of the investment company or investment trust consists substantially of investments that are not prohibited by the governing instrument. The fact that the bank or trust company or an affiliate of the bank or trust company provides services to the investment

company or investment trust, such as those of an investment advisor, custodian, transfer agent, registrar, sponsor, distributor, manager, or otherwise, and receives compensation for those services does not precluded the bank or trust company from investing or reinvesting in the securities if the compensation is disclosed by prospectus, account statement, or otherwise. An executor or administrator of an estate under a dependent administration or a guardian of an estate shall not so invest or reinvest unless specifically authorized by the court in which such estate or guardianship is pending.

8.12.3.4.3 Texas Trust Code § 113.054: provides that:

A trustee of one trust may not sell property to another trust of which it is also trustee unless the property is:

(1) a bond, note, bill, or other obligation issued or fully guaranteed as to principal and interest by the United States; and

(2) sold for its current market price.

8.12.3.4.4 Texas Trust Code § 113.055: provides that:

(a) Except as provided by Subsection (b) of this section, a corporate trustee may not purchase for the trust the stock, bonds, obligations, or other securities of the trustee or an affiliate, and a non-corporate trustee may not purchase for the trust the stock, bonds, obligations, or other securities of a corporation with which the trustee is connected as director, owner, manager, or any other executive capacity.

(b) A trustee may:

(1) retain stock already owned by the trust unless the retention does not satisfy the requiremenst prescribed by Chapter 117.

(2) exercise stock rights or purchase fractional shares under Section 113.053 of this Act.

8.12.3.4.5 Texas Trust Code § 113.057: provides that:

(a) A corporate trustee may deposit trust funds with itself as a permanent investment if authorized by the settlor in the instrument creating the trust or if authorized in a

> writing delivered to the trustee by a beneficiary currently eligible to receive distributions from a trust created before January 1, 1988.
>
> (b) A corporate trustee may deposit with itself trust funds that are being held pending investment, distribution, or payment of debts if, except as provided by Subsection (d) of this section:
>
> > (1) it maintains under control of its trust department as security for the deposit a separate fund of securities legal for trust investments;
> >
> > (2) the total market value of the security is at all times at least equal to the amount of the deposit; and
> >
> > (3) the separate fund is marked as such.
>
> (c) The trustee may make periodic withdrawals from or additions to the securities fund required by Subsection (b) of this section as long as the required value is maintained. Income from securities in the fund belongs to the trustee.
>
> (d) Security for a deposit under this section is not required for a deposit under Subsection (a) or under Subsection (b) of this section to the extent the deposit is insured or otherwise secured under state or federal law.

8.12.3.4.6 Texas Trust Code §§114.001(a) provides that:

> (a) **The trustee is accountable to a beneficiary for the trust property and for any profit made by the trustee through or arising out of the administration of the trust, even though the profit does not result from a breach of trust**; provided, however, that the trustee is not required to return to a beneficiary the trustee's compensation as provided by this subtitle, by the terms of the trust instrument, or by a writing delivered to the trustee and signed by all beneficiaries of the trust who have full legal capacity. (emphasis supplied)

8.12.3.4.7 Texas Common Law: *Pomeroy Equity Jurisprudence,* 5th Ed. §955 -965; *Johnson v. Peckham,* 120 S.W.2d 786 (Tex. 1938); *Kinzbach Tool Company v. Corbett-Wallace,* 160 S.W.2d 509 (Tex.1942); *International Bankers Life Insurance Company v. Holloway,* 368 S.W.2d

657 (Tex. 1963); *Archer v. Griffith*, 390 S.W.2d 735 (Tex. 1964); *Stephens County Museum v. Swenson* 517 S.W.2d 257 (Tex. 1974); *Texas Bank and Trust Company v. Moore* 595 S.W.2d 502 (Tex. 1980); *Loewenstein v. Watts*, 119 S.W.2d 176 (Tex. Civ. App.--El Paso), aff'd. 134 Tex. 660, 137 S.W.2d 2 (1938); *Gaines v. First State Bank*, 28 S.W.2d 297, aff'd., 121 Tex. 559, 50 S.W.2d 774 (Tex. 1930); and *Albuquerque National Bank v. Citizens National Bank*, 212 F.2d 943 (5th Cir. 1954). *Johnson v. Peckham* 120 S.W.2d 786 (Tex. 1938); ; *Archer v. Griffith* 390 S.W.2d 735 (Tex. 1964) and *Ginther v. Taub* 570 S.W.2d 516 (Tex. Civ. App. - Waco 1978, writ ref'd n.r.e.).

8.12.4 **The relationship between the statutory prohibitions against self dealing and the common law prohibitions against self dealing**. Even if a statutory duty is waived, such waiver operates only to subject the trustee to constructive fraud burden of proving that the transaction is fair to the beneficiary. This interrelation was explained by the court in *InterFirst Bank Dallas, N.A. v. Risser,* 739 S.W.2d 882 (Tex. App.--Texarkana, 1987, writ denied). The *Risser* court observed that:

> Tex. Rev. Civ. Stat. Ann. art. 7425-12 (Texas Trust Act) prohibits a trustee buying from or selling trust assets to itself, from lending trust funds to itself, and a corporate trustee from buying its own stock for the trust. These provisions also prohibit such dealing by entities closely related to the trustee.
>
> However, the statutory prohibition does not exhaust the possibilities of conflicts of interest by a trustee. Any type of activity by the trustee which gives the trustee an advantage to the detriment of the beneficiaries could be construed as self-dealing. This would not include the trustee's right to reasonable compensation, nor should it include an activity not prohibited by statute in which the trustee does not use his position as trustee to gain such an advantage.
>
> The earlier Texas trust cases involving breaches of fiduciary duty did not use the term self-dealing; nor did the cases make a clear distinction between self-interest, which was a statutory violation, as opposed to a conflict of interest situation. For example, the acts involved in *Slay v. Burnett Trust, supra*, seem to involve both a statutory violation and a conflict of interest, but the court did not draw any distinction between the two activities.
>
> Perhaps it would be simpler if all Texas cases divided themselves into a neat dichotomy of those which involve statutory self-dealing and those which involve conflicts of interest not covered by the statute. However, such a clear division of terms does not exist in the case law. It has been suggested that it would be helpful to the courts to determine what is self-dealing and what is a conflict of interest but not self-dealing, so that the courts could then assess whether the danger of permitting the trustee to engage in the action must be so great as to make the action wholly impermissible or only such as to make the action permissible if justifiable. J. *Dukeminier & S. Johanson*, Wills, Trusts, and Estates, 870 (3d ed. 1984). Even in cases involving statutory self-

dealing, Texas courts have not always said that such action was absolutely impermissible. *Humane Society of Austin and Travis County v. Austin National Bank*, 531 S.W.2d 574 (Tex.1975). In the *Humane Society* case, the trustee violated the prohibition against lending trust funds to itself (done in the form of certificates of deposit), but the court found that it was not in furtherance of its own self-interest to the detriment of the estate. Thus in a broad sense, self-dealing and the duty of loyalty are entwined to require the trustee to forego his own personal interest and opportunities for gain with respect to property subject to the fiduciary relationship and to act completely in the interest of the beneficiaries of the relationship. *Kinney v. Shugart*, 234 S.W.2d 451 (Tex.Civ.App.-Eastland 1950, writ ref'd). Historically, one of the reasons to separate self-dealing (in the narrow sense of a trustee buying trust property or selling his own property to the trust) from other types of conflicts of interest was that self-dealing required strict liability. Once it had been established that there was self-dealing, the no-further-inquiry rule came into play. This rule essentially said that good faith and fairness were not enough to save the trustee from liability if the trustee had engaged in self-dealing. For example, in the case of *Harvey v. Casebeer*, 531 S.W.2d 206 (Tex.Civ.App.-Tyler 1975, no writ), the court held that when there is a self-dealing transaction that is forbidden by statute, the beneficiary can attack it even though he has suffered no damage and the trustee has acted in good faith.

In the present case, there was no statutory self-dealing. But there are many situations outside the statutory prohibition which may be deemed to be self-dealing if the trustee actually takes advantage of his position as trustee to the detriment of the trust.

The duty of fidelity required of a trustee forbids the trustee from placing itself in a situation where there is or could be a conflict between its self-interest and its duty to the beneficiaries. *Slay v. Burnett Trust, supra*. It is incompatible for a trustee to connect his own interest with his dealings as a trustee for another. The rule is founded on the danger of imposition of the trustee's personal interest and the presumption of the existence of fraud inaccessible to the eye of the court. *Nabours v. McCord*, 97 Tex. 526, 80 S.W. 595 (1904). A trustee may not use his position to obtain any advantage that is inconsistent with his primary duty to the beneficiaries. *MacDonald v. Follett*, 142 Tex. 616, 180 S.W.2d 334 (1944).

The Texas Trust Code (and related Texas cases) do allow a trustor to relieve the trustee from the strict liability prohibitions against certain forms of self dealing. See Texas Trust Code §§ 113.052, 113.053, 113.054 and 113.055. Even if strict liability for self dealing is waived, the trustee remains liable to the beneficiaries under the constructive fraud theory. In this situation the trustee must prove that the transaction is "fair" to the beneficiaries of the trust.

The previous explanation of the interrelation between statutory and common law prohibitions against self dealing was drafted prior to the *Grizzle* opinion. It remains to be seen if this is currently the law in Texas.

8.13 **THE FIDUCIARY DUTY TO MAKE TRUST PROPERTY PRODUCTIVE**:

8.13.1 **The Duty**: The trustee is under a duty to use reasonable care and skill to make the trust property productive.

8.13.2 **Commentary:** If a trustee commits a breach of trust by neglecting, within a reasonable time, to invest money comprising a portion of the trust estate, he is chargeable with the amount of income which would normally accrue from proper trust investments.

8.13.3 **Authority:**

8.13.3.1 ***The Restatement of Trusts 2d, supra* §181:** provides that:

> The trustee is under a duty to the beneficiary to use reasonable care and skill to make the trust property productive.

8.13.3.2 ***Scott, supra* §181:**

> Ordinarily it is the duty of the trustee to invest trust funds so that they will be productive of income.

8.13.3.3 ***Bogert, supra* §611:**

> A trustee almost always has the duty to cause the trust property to produce income. The duty may be either express or implied. The duty to invest and make the trust property productive must be performed within a reasonable time, considering the difficulty or ease of finding an appropriate investment and other circumstances.

8.13.3.4 **Texas Law:**

8.13.3.4.1 Texas Trust Code §116.176 applies only to property held in trust which qualifies for the marital deduction. Otherwise, the duty to make property productive is consumed by the general prudent investor rule.

8.13.3.4.2 Texas Trust Code §114.001(b): provides that:

> The trustee is not liable to the beneficiary for a loss or depreciation in value to the trust property **or for a failure to make a profit** that does not result from a failure to perform the duties set forth in this subtitle or from any other breach of trust. (emphasis supplied)

8.13.3.4.3 Texas Common Law: *Langford v. Shamburger*, 417 S.W.2d 438, 444-445 (Tex. Civ. App. - Ft. Worth 1967, writ ref'd n.r.e.)

8.14 **THE FIDUCIARY DUTY TO PAY INCOME TO THE BENEFICIARY**:

8.14.1 **The Duty**: The trustee has a duty to comply with the terms of the trust dealing with the payment of income to income beneficiaries.

8.14.2 **Commentary:** The trustee can properly withhold a reasonable amount of the income to meet present or anticipated expenses which are properly chargeable to income. The trustee may also properly withhold income for his protection where there is reasonable doubt as to the amount of income payable to the beneficiary. The trust may authorize the trustee to accumulate all or any part of the income or grant the trustee discretion regarding the payment of income in these situations, the trustee may not be required to pay income to the beneficiary. See comments to *Restatement 2nd §182*.

8.14.3 **Authority:**

8.14.3.1 **The Restatement of Trusts 2d, supra § 182**: provides that:

> Where a trust is created to pay the income to a beneficiary for a designated period, the trustee is under a duty to the beneficiary to pay him at reasonable intervals the net income of the trust property.

8.14.3.2 ***Scott, supra* §182**:

> Where the income from the trust estate is payable to a beneficiary for life or for a designated period, the trustee is under a duty to pay him the net income, after deducting rom the gross income the expenses properly incurred in the admin istration of the trust.

8.14.3.3 ***Bogert, supra* § 814**:

> It is generally held that a trustee is under an unqualified and absolute duty to make payments and distributions to the beneficiaries entitled thereto, rather than merely to use the care and judgment of a man of reasonable prudence in distributing trust property. His equitable obligation is deemed to be like that of a contract debtor who is not absolved by showing that he tried in good faith and with the ability of an ordinary prudent man to make payment. By accepting the trust the trustee is considered as having assumed an unconditional obligation to follow the applicable provisions regarding payments and distributions.

8.14.3.4 **Texas Law:**

8.14.3.4.1 Texas Trust Code: There is no provision in Texas Trust Code specifically imposing a duty on the trustee to pay income. There are, however, special statutory provisions relating to the payment of distributions to a minor or incapacitated beneficiary (Tex. Trust Code §113.021 - the statutory facilities of payments provision)

8.15 **THE FIDUCIARY DUTY TO PRESERVE AND PROTECT TRUST PROPERTY**:

8.15.1 **The Duty**: The trustee is under a duty to preserve and protect the trust estate.

8.15.2 **Commentary:** Except as otherwise provided by the trust instrument, it is the duty of the trustee to exercise such care and skill to preserve the trust estate as a man of ordinary prudence would exercise in dealing with his own property, and if he has greater skill than a man of ordinary prudence, he is under a duty to exercise such skill as he has. Comment a. to *Restatement 2nd §176.* This duty has been modified by the standards of the Prudent Investor Rule.

8.15.3 **Authority:**

8.15.3.1 ***The Restatement of Trusts 2d, supra* §176:** provides that:

> The trustee is under a duty to the beneficiary to use reasonable care and skill to preserve the trust property.

8.15.3.2 ***Scott, supra* §176:**

> It is the duty of the trustee to use care and skill to preserve the trust property. The standard of care and skill that is applicable to this duty, as it is to other duties, is that of a man of ordinary prudence.

8.15.3.3 **Texas Law:**

8.15.3.3.1 Texas Trust Code: There is no specific statutory duty to preserve and protect the trust estate. See, however, Tex. Trust Code §117.004 which deals with the investment standard for a trustee.

8.15.3.3.2 Texas Trust Code §117.006 provides: "Within a reasonable time after accepting a trusteeship or receiving trust assets, a trustee shall review the trust assets and make and implement decisions concerning the retention and disposition of assets, in order to bring the trust portfolio into compliance with the purposes, terms, distribution requirements and other circumstances of the trust, and with the requirements of this chapter." This is a change from prior Texas law which allowed a trustee to retain any assets delivered to the trustee without liability. Tex. Trust Code §113.003, repealed.

8.16 **THE FIDUCIARY DUTY OF PRUDENCE**:

8.16.1 **The Duty**: The trustee has a duty to the beneficiary to use the skill and prudence which an ordinary capable and careful person will use in the conduct of his own affairs.

8.16.2 **Commentary:**

8.16.2.1 **Evolution:** The prudent man rule was set forth in Texas Trust Code §113.056. This statute is repealed by the 2003 Legislature effective January 1, 2004 and has replaced by the Texas Uniform Prudent Investor Act (Texas Trust Code §117.001, *et seq.*)

8.16.2.2 **Speculation:** The general rule, a trustee may not engage in speculative investments has been repealed by the Prudent Investor Rule.

Such investments may be made as part of the overall portfolio, but must still meet the general rule of prudence.

8.16.2.3 **Diversification:** Restatement 2nd § 228 provides:

> Except as otherwise provided by the terms of the trust, the trustee is under a duty to the beneficiary to distribute the risk of loss by a reasonable diversification of investments, unless under the circumstances it is prudent not to do so.

8.16.2.4 **Periodic Review of Trust Investments:** A trustee has the duty of examining and checking the trust investments periodically through the live of the fiduciary relationship. *Jewett v. Capital National Bank of Austin,* 618 S.W.2d. 109 (Tex. Civ. App.--Waco 1981, writ ref'd n.r.e.); *Bogert, supra,* § 684.

8.16.3 **Authority:**

8.16.3.1 **The Restatement of Trusts 3rd supra §227-9:**

§227 General Standard of Prudent Investment.

> The trustee is under a duty to the beneficiaries to invest and manage the funds of the trust as a prudent investor would, in light of the purposes, terms, distribution requirements, and other circumstances of the trust.
>
> (a) This standard requires the exercise of reasonable care, skill, and caution, and is to be applied to investments not in isolation but in the context of the trust portfolio and as a part of an overall investment strategy, which should incorporate risk and return objectives reasonably suitable to the trust.
>
> (b) In making and implementing investment decisions, the trustee has a duty to diversify the investments of the trust unless, under the circumstances, it is prudent not to do so.
>
> (c) In addition, the trustee must:
>
> > (1) Conform to fundamental fiduciary duties of loyalty ... and impartiality;
> >
> > (2) act with prudence in deciding whether and how to delegate authority and in the selection and supervision of agents; and
> >
> > (3) incur only costs that are reasonable in amount and appropriate to the investment responsibilities of the trusteeship.

(d) The trustee's duties under this Section are subject to the rule of §228, dealing primarily with contrary investment provisions of a trust or statute.

§228 Investment Provisions of Statute or Trust
In investing the funds of the trust, the trustee

(a) has a duty to the beneficiaries to conform to any applicable statutory provisions governing investment by trustees; and

(b) has the powers expressly or impliedly granted by the terms of the trust and, except as provided in § § 165 through 168, has a duty to the beneficiaries to conform to the terms of the trust directing or restricting investment by the trustee.

§229 Duty with Respect to Original Investments

The trustee is under a duty to the beneficiaries within a reasona0lbe time after the creation of the trust, to review the contents of the trust estate and to make and implement decisions concerning the retention and disposition of original investments in order to conform to the requirements of §227 and § § 228.

8.16.3.2 ***Scott, supra* § 228**:

The trustee should exercise prudence in diversifying investments so as to minimize the risk of large losses. He should not therefore invest more than a reasonable proportion of the trust estate in a single security, or, it would seem, in a single type of security. This a commonplace among experts in the are of making investments. It is not clear, however, how far the trustee is subject to liability for failure to diversity investments.

8.16.3.3 ***Bogert, supra* §541:**

All trustees are subject to common law duties and equitable rules or principles which in some instances have been codified by statute. For example, the trustee must not personally profit from his administration of the trust. The trustee must continually demonstrate good faith in administering the trust and in dealing with beneficiaries.

The trustee has the duty to collect and preserve the property made subject to the trust. The trustee is under a duty to segregate the trust assets and not to mingle them with his own assets or the assets of other trusts. A fundamental duty of the trustee is to carry out the directions of the testator or settlor as expressed in the terms of the trust. Any attempt to take action contrary to the settlor's directions may

be deemed to constitute a unilateral and invalid deviation from the trust terms even though the trustee is otherwise given broad discretions in administering the trust. The duty to keep the beneficiaries informed and to account to them, directly or through court proceedings, is discussed in another Chapter. A trustee who holds for successive beneficiaries owes a duty to them to administer the trust with impartial consideration for the interests of all the beneficiaries. He should not unnecessarily show a preference either for the current beneficiaries or for the remaindermen who may be or become entitled to principal at a future date. In making investments and sales, disposing of receipts, paying expenses, and making other decisions, the trustee should endeavor to act in such a way that a fair result is reached with regard to the interests of the current or income beneficiaries and those who take possession of their interests at a subsequent date.

In those states that have adopted the Uniform Probate Code, a trustee has the duty to register the trust with the court of the state "at the principal place of administration."

In this Chapter the general standards of conduct imposed by common law on trustees, and sometimes imposed by statute, are first examined, and thereafter the various ramifications of the trustee's duty of undivided loyalty to the trust are examined in some detail. As shown in later sections of this Chapter, there are many aspects to this basic duty of loyalty, including the requirement that the trustee avoid or remove any conflict of interest between his personal interests and those of the trust and the beneficiaries, and the duty to administer the trust solely for the benefit of the beneficiaries and thereby exclude the interests of others as well as his own personal interest. The trustee's duty to avoid "self-dealing" constitutes a substantial portion of the broader duty of undivided loyalty to the trust and is analyzed in many of the sections to follow. Generally, self-dealing transactions are those by which the trustee benefits himself at the expense of the trust. However the duty of undivided loyalty may be violated by the trustee's actions benefitting persons who are not beneficiaries and who are not affiliated with or related to the trustee.

Standard of Care. In his management of the trust, the trustee is required to manifest the care, skill, prudence, and diligence of an ordinarily prudent man engaged in similar business affairs and with objectives similar to those of the trust in question. The court does not examine the conduct of the

> trustee and determine in each case whether he acted reasonably, but rather compares his action with the external standard of the ordinarily prudent and skillful man.

8.16.3.4 **Texas Law:**

8.16.3.4.1 Texas Trust Code §117.005 now provides: "A trustee shall diversify the investments of the trust unless the trustee reasonably determines that, because of special circumstances, the purposes of the trust are better served without diversifying." The above text in Bogert and Scott must be read in light of this statute.

8.16.3.4.2 Texas Common Law: The common law duty to exercise ordinary skill and prudence is usually stated as follows:

> The fundamental duties of a trustee include the use of the skill and prudence which an ordinary capable and careful person will use in the conduct of his own affairs . . .

InterFirst Bank Dallas, N.A. v. Risser, 739 S.W.2d 882, 888 (Tex. Civ. App. -- Texarkana 1987, no writ), citing *Tucker v. Dougherty Roofing Company*, 137 S.W.2d 884 (Tex. Civ. App. -- Dallas 1940, writ dism'd judgment cor.)

8.17 **THE FIDUCIARY DUTY TO TAKE AND KEEP CONTROL**:

8.17.1 **The Duty**: The trustee is under a duty to take and keep control of the trust estate.

8.17.2 **Commentary:** This duty requires the trustee to be diligent in collecting and administering all property conveyed into the trust estate of the trust by the settlor and/or other grantor. With respect to testamentary trusts, it requires that the trustee collect from the executor or administrator all estate property conveyed to the trust estate by the will.. It also requires successor trustees to collect and administer all property comprising the trust estate from the former trustee.

8.17.3 **Authority:**

8.17.3.1 ***The Restatement of Trusts 2d, supra* §175:** provides that:

> The trustee is under a duty to the beneficiary to take reasonable steps to take and keep control of the trust property.

8.17.3.2 **Scott, supra §175:**

> The trustee is under a duty to take such steps as are reasonable to secure control of the trust property and to keep control of it. Thus, in the case of a testamentary trust where on person is named as executor and another as trustee, it is the duty of the trustee to obtain possession of the trust property from the executor, and if he does not within a reasonable time take such steps as are reasonable to obtain possession of the property and the executor

> thereafter makes away with the property, the trustee is liable to the beneficiaries for the loss. So, also, it is held that where the trustees under a marriage settlement fail to reduce the trust property to possession and a loss occurs, they are liable. In *Ex parte Ogle* a debtor assigned his property to the defendant as trustee for his creditors. Included in the property assigned was a quantity of wine and spirits that the trustee permitted to remain in the possession of the debtor, who consumed most of it. It was held that the trustee was liable to the creditors for the loss.

8.17.3.3 ***Bogert, supra* §583:**

> After a trustee has accepted the trust and qualified as required by the law of the state in question, by filing an oath, giving bond, or taking such other steps as the statute, rule of court, or the trust instrument requires, it becomes his duty to carefully examine the terms of the trust and the trust assets in order to determine exactly what property forms the subject matter of the trust, who are the beneficiaries, and what are the trustee's duties with respect to the trust property and the beneficiaries. By the very definition of a trust, the trustee must have some property interest in the things designated as the trust res, and in nearly all cases this interest is an absolute interest in personalty or a fee interest in realty, and is a present estate or interest entitling the trustee to immediate possession of realty or personalty. The duties of the trustee almost universally require him to take into his possession tangible realty or personalty, and to reduce choses in action to possession. This duty of obtaining physical dominion over the trust estate and the documents representing it is a primary obligation of the trustee toward the beneficiary. Since it comes first in the chronology of trust administration, it may well be treated first in settling forth various specific duties of the trustee.

8.17.3.4 **Texas Law:**

8.17.3.4.1 Texas Trust Code: There is not specific statutory provision relating to this duty.

8.18 **THE FIDUCIARY DUTY TO UPHOLD AND DEFEND THE TRUST**:

8.18.1 **The Duty**: The trustee is under a duty to actively defend any attack on the validity of the trust or any of its provisions.

8.18.2 **Commentary:** The trustee usually has a duty to uphold and defend the validity of the trust. The trustee is usually entitled to receive his interim attorneys fees and costs from the trust estate of the trust whether or not he prevails in the attack against the trust. There is, of course a paradox here, if the attack on the validity of the trust succeeds, there is no trust estate.

In the author's opinion there should be one exception to this duty, if a person participates in the creation of a trust which appoints such person trustee - this duty should not allow such person to defend the validity of the trust out of the trust estate unless such person prevails in the attack against the validity of the trust.

It is the author's experience that, if the attack on the trust is successful, and parties acted improperly in causing the settlor to create the trust (i.e. in situations where the settlor in incapacitated or unduly influenced) then the courts will award the legal fees of the trustee against the party engaged in the improper activity.

8.18.3 **Authority:**

8.18.3.1 **The Restatement of Trusts 2d, supra §178**:

> The trustee is under a duty to the beneficiary to defend actions which may result in a loss to the trust estate, unless under all the circumstances it is reasonable not to make such defense.

8.18.3.2 ***Scott, supra §178***

> ....It is the duty of the trustee to the beneficiaries of the trust to prevent the destruction of the trust. Thus, where the settlor or his successors in interest seek to rescind the trust on the ground that the settlor was induced by undue influence or mistake to create the trust, it is the duty of the trustee to defend the trust and resist the proceeding to the extent to which it is reasonable to require him to do so. The trustee is, of course, entitled to reimbursement out of the trust estate for the expenses he incurs in defending the trust.
>
> Clearly, the trustee owes a duty to the beneficiaries not to destroy the trust. When sued by the beneficiaries for the enforcement of the trust, he is not permitted to set up defects in the settlor's title. He cannot avail himself of an outstanding title either in himself or in a third person.

8.18.3.3 ***Bogert, supra* §581:**

> An effort to invalidate or attack a trust may be made in a number of different ways by one or more parties. The settlor himself may seek to set aside the trust conveyance on the ground of fraud, undue influence, duress, or similar reason, or his successors in interest may seek a decree of invalidation for these reasons or because of mental incapacity of the settlor. The creditors of the settlor may attack the trust on the global ground that it was executed in fraud of them. A claim may be made that the trust violates the Rule Against Perpetuities, a mortmain act, or similar statutory or common law rule or policy. The beneficiaries may seek to

> terminate the trust prematurely. Creditors of a beneficiary may seek to reach the interest of the beneficiary, which may or may not be protected by spendthrift provisions. ...
>
> Equity imposes upon the trustee the duty of defending the integrity of the trust if he has reasonable ground for believing that the attack is unjustified or if he is reasonably on doubt on that subject. Where it ought to be entirely clear to any person of ordinary intelligence, after taking legal advice, that the attach is warranted and that the trust is defective and should not be set aside in whole or in part, or that for other reason a defense would be futile or unnecessary, he trustee has no duty to incur expense to defend the suit. As in the performance of all his other duties the trustee must act with prudence and skill of a reasonably prudent man.

8.18.3.4 **Texas Law:**

8.18.3.4.1 Texas Trust Code: There is no statutory duty to uphold and defend the trust.

8.18.3.4.2 Texas Common Law: A trustee cannot by legal action destroy the trust or subject matter thereof so long the fiduciary relationship remains in existence. *Brigs v. Brigs,* 346 S.W.2d 106 (Tex. 1961); *Mason v. Mason,* 366 S.W.2d 552 (Tex. 1963); *First National Bank of Port Arthur v. Sassine,* 556 S.W.2d 116 (Tex. Civ. App. 1977, no writ).

In *Branult v. Bigham,* 493 S.W.2d 576 (Tex. App. -- Waco [10th Dist], 1973 the court held that:

> A trustee commits a breach of trust not only where he violates a duty in bad faith, or intentionally although in good faith, or negligently, but also where he violates a duty because of a mistake. An intended or attempted appropriation is just as much an indication of danger as though it had been consummated, and hence is a ground for removal. Similarly a repudiation of the trust is a clear ground for removal. Restatement of Trust 2nd Ed. Par. 201... And a person who sues to recover property for his own right repudiates a trust relation to such property. *Portis v. Hill,* S.Ct. p.4, 14 Tex. 69; *Childers v. Breese,* 202 Okla. 377, 213 P.2d 565; *Ballard v. Ballard CCA,* NWH, 296 S.W.2d 811.

8.19 **THE FIDUCIARY DUTY WITH RESPECT TO BANK DEPOSITS**:

8.19.1 **The Duty**: The trustee must use reasonable care in connection with the deposit of funds comprising the trust estate of the trust in a bank or other financial institution.

8.19.2 **Commentary:** This duty would probably require a trustee to insure that bank deposits are insured by the Federal Deposit Insurance Corporation or an equivalent insurer.

If the trustee deposits a portion of the trust estate at interest in a bank, this duty would require him to receive a reasonable interest rate on the deposits.

This duty (and the duty of loyalty and the duty not to self deal) would prevent a trustee from using the deposit of funds comprising the trust estate of the trust to enhance his personal credit with the bank or to personally receive any other benefit from the bank.

This duty would also apply to other institutions now performing banking deposit services such as brokerage firms.

8.19.3 **Authority:**

8.19.3.1 **The Restatement of Trusts 2d, supra §180:** which provides that:

> While a trustee can properly make general deposits of trust money in a bank, it is his duty to the beneficiary in making such deposit to use reasonable care in selecting the bank, and properly to earmark the deposit as a deposit by him as trustee.

8.19.3.2 **Scott, supra §180:**

> A trustee ordinarily cannot properly lend trust money without security. In a sense a deposit in a bank is a loan to the bank of the money deposited. Nevertheless, it is of course not improper for a trustee to deposit trust funds in a bank. Usually it is safer to preserve the trust funds in this manner than by keeping them in the form of actual cash. Such a deposit is usually not a form of investment but is a method of safekeeping. If the trustee acted properly in making the deposit, he incurs no liability if the bank fails.
>
> There are three questions which may arise as to the deposit of trust money in a bank:
>
> (1) whether a deposit by a bank with itself is proper. This has already been considered,
>
> (2) whether a trustee is liable if the bank fails,
>
> (3) whether a trustee should deposit the money in an account that earns interest.

The trustee may incur a liability, however if he acts improperly in making the deposit. He may be liable for a breach of trust

(1) if he fails to use reasonable care in the selection of the bank;

(2) if he fails to earmark the deposit as one made by him as trustee;

(3) if he leaves the money on deposit for an unreasonably long time; or

(4) if he makes an arrangement with the bank which precludes him from withdrawing the deposit at any time.

These four situations are considered in the following sections.

8.19.3.3 **Texas Law:**

8.19.3.3.1 Texas Trust Code §113.007: which provides that:

> A trustee may deposit trust funds that are being held pending investment, distribution, or the payment of debts in a bank that is subject to supervision by state or federal authorities. However, a corporate trustee depositing funds with itself is subject to the requirements of Section 110.057 of this code.

8.19.3.3.2 Texas Trust Code §113.057: which provides that:

> (a) A corporate trustee may deposit trust funds with itself as a permanent investment if authorized by the settlor in the instrument creating the trust or if authorized in a writing delivered to the trustee by a beneficiary currently eligible to receive distributions from a trust created before January 1, 1988.
>
> (b) A corporate trustee may deposit with itself trust funds that are being held pending investment, distribution, or payment of debts if, except as provided by Subsection (d) of this section:
>
> > (1) it maintains under control of its trust department as security for the deposit a separate fund of securities legal for trust investments;
> >
> > (2) the total market value of the security is at all times at least equal to the amount of the deposit; and

> (3) the separate fund is marked as such.
>
> (c) The trustee may make periodic withdrawals from or additions to the securities fund required by Subsection (b) of this section as long as the required value is maintained. Income from securities in the fund belongs to the trustee.
>
> (d) Security for a deposit under this section is not required for a deposit under Subsection (a) or under Subsection (b) of this section to the extent the deposit is insured or otherwise secured under state or federal law.

8.19.3.3.3 Texas Common Law: *See Humane Society of Austin and Travis County v. Austin National Bank*, 531 S.W.2d 574 (Tex.1975) in this case the court allowed a corporate trustee to invest in certificates of deposit in its own bank.

8.20 **THE FIDUCIARY DUTY WITH RESPECT TO CO-TRUSTEES**:

8.20.1 **The Duty**: Each co-trustee has a duty to: (1) participate in the administration of the trust; (2) use reasonable care to prevent a co-trustee from breaching the trust; and (3) to redress a breach of trust by a co-trustee.

8.20.2 **Commentary:** In situations where there are individual and corporate co-trustees, the individual trustee frequently does not participate in the administration of the trust and will be held liable for a breach by the corporate co-trustee.

8.20.3 **Authority:**

8.20.3.1 ***The Restatement of Trusts 2d, supra* §184:** which provides that:

> If there are several trustees, each trustee is under a duty to participate in the administration of the trust and to use reasonable care to prevent a co-trustee from committing a breach of trust or to compel a co-trustee to redress a breach of trust.

8.20.3.2 ***Scott, supra* §184:**

> Where there are several trustees it is the duty of each of them, unless it is otherwise provided by the terms of the trust, to participate in the administration of the trust. A trustee is under a duty not to delegate to third persons the doing of acts that he can reasonably be required personally to perform. Similarly, a trustee cannot properly delegate the doing of such acts to his co-trustees. It is improper for one of the trustees to leave to the others the control over the administration of the trust. A trustee who remains inactive is guilty of a breach of trust. It is improper for one trustee to leave to the others the custody and control of the

> trust property. It is the duty of each to use reasonable care to prevent the others from committing a breach of trust; if one of the trustees commits a breach of trust, it is the duty of the others to compel him to redress it. We shall consider hereafter the question of the exercise of powers where there are several trustees and the question of liability of one trustee when another commits a breach of trust.

8.20.3.3 ***Bogert, supra*: §584-587**

8.20.3.4 **Texas Law:**

8.20.3.4.1 Texas Trust Code §113.085: which provides that:

> Except as otherwise provided by the trust instrument or by court order:
>
> (1) a power vested in three or more trustees may be exercised by a majority of the trustees; and
>
> (2) if two or more trustees are appointed by a trust instrument and one or more of the trustees die, resign, or are removed, the survivor or survivors may administer the trust and exercise the discretionary powers given to the trustees jointly.

8.21 **THE FIDUCIARY DUTY WITH RESPECT TO THE PERSON HOLDING THE POWER TO CONTROL**:

8.21.1 **The Duty**: The trustee is under a duty to comply with trust provisions delegating administrative decisions to a particular individual unless the acts of such individual violate the terms of the trust instrument or breach a fiduciary duty.

8.21.2 **Commentary:** The trust instrument may delegate to a particular cc-trustee or to a third person the power to make administrative decisions to the exclusion of any other person.

8.21.3 **Authority:**

8.21.3.1 ***The Restatement of Trusts 2d, supra* §185:** which provides that:

> If under the terms of the trust a person has power to control the action of the trustee in certain respects, the trustee is under a duty to act in accordance with the exercise of such power, unless the attempted exercise of the power violates the terms of the trust or is a violation of a fiduciary duty to which such person is subject in the exercise of such power.

8.21.3.2 **Scott, supra §185:**

By the terms of the trust it may be provided that the action of the trustee in certain respects shall be subject to the control of another. The person on whom such power of control is conferred may be a co-trustee, a beneficiary, the settlor, or a third person otherwise unconnected with the trust. The extent of the power thus conferred depends, of course, on the provisions of the trust instrument. The power may be a power to veto certain acts of the trustee in the administration of the trust, as for example, where it is provided that the trustee shall make no investment without the consent of the settlor or of a beneficiary or of a third person, or that the trustee shall not sell trust property without such consent. The power may be a power to compel certain action by the trustee, as, for example, where it is provided that the trustee shall make such investments as the settlor, a beneficiary, or a third person may direct, or that he shall sell trust property if so directed. Where there are several trustees, they cannot exercise the powers conferred on them unless they all concur, if it is not otherwise provided by the terms of the trust or by statute; but it may be provided by the terms of the trust that where the trustees disagree the directions of one of them shall be controlling on the others.

8.21.3.3 ***Bogert, supra*: §587**

In many cases the evidence shows not only exclusive control by the active trustee, obtained through the acquiescence or affirmative aid of the inactive trustee, but also the lapse of a considerable period of time after such entrusting, with no investigation by the inactive trustee of the conduct of the active trustee. This situation raises the question whether failure to supervise the work of a co-trustee, for example, failure to examine the investments made by him, is such negligence as to render the inactive trustee liable for loss to the trust estate.

The English cases have been unanimous in asserting a duty to review an active co-trustee in exclusive control, to examine his accounts, and to inspect his investments. To fail to give such supervision has been held negligence, rendering the passive trustee liable, whether the active trustee acquired exclusive control through the mere passivity of the inactive trustee or through his positive action.

The American cases also generally place upon the inactive trustee the duty of supervising and inspecting the work of the active trustee. A trustee who, by failure to act or by delegation or other direct action, has enabled his co-trustee to obtain

exclusive possession of the trust subject-matter must examine the investments and accounts of the active colleague. Thus in *Richards v. Seal* an inactive trustee, who for eleven years made no examination of the status of a bond entrusted to a co-trustee, and thus failed to learn that the co-trustee had collected it and held the proceeds uninvested, was held liable for a loss resulting from the inability of the co-trustee to turn over the money. This duty to supervise exists, whether the inactive trustee, at the time he becomes a trustee, finds the co-trustee in control, or has passively allowed the co-trustee to take exclusive possession or has by his own positive act put the co-trustee into possession.

If the trust directs that the funds be invested in a particular way, for example, in mortgages upon real estate, the duty of the inactive trustee to supervise the conduct of the active associate would seem to be accentuated, if anything. For failure to make such inspection, resulting in the continuance of an improper investment, the passive trustee has been charged. The opinion of the Tennessee court is forcefully put by *Turley, J., in Deaderick v. Cantrell*, as follows:

> "Two trustees are appointed to execute a trust, the final operation of which is not to be completed for years, they undertake to execute it, they are intended as checks on each other, have an equal control over the fund, are mutually bound to attend to the interest of the trust, and shall one of them be permitted to go to sleep and trust everything to the management of his co-trustee, and when in the course of ten or fifteen years the fund having been wasted, and his co-trustee insolvent, he is called upon to make it good, shall he be heard to say that he had implicit confidence in his companion, and permitted him to retain all the money and appropriate it as he pleased, and that he ought not therefore to be charged? Surely not, it is neither law nor reason."

8.21.3.4 **Texas Law:**

8.21.3.4.1 Texas Trust Code §114.003: which provides that:

> If a trust instrument reserves or vests authority in a person to the exclusion of the trustee, including the settlor, an advisory or investment committee, or one or more co-trustees, to direct the making or retention of an investment or to perform any other act in

> the management or administration of the trust, the excluded trustee or co-trustee is not liable for a loss resulting from t he exercise of the authority in regard to the investments, management, or administration of the trust.

8.21.3.4.2 See also Tex. Trust Code §117.001 relating to the delegation of investment decisions and other management functions.

9 **SOME TRUST LITIGATION ISSUES RAISED BY THE UNIFORM ACTS**.
This is not meant to be an exhaustive analysis as to how these Acts change the face of litigation, but only some thoughts which occur early in their history.

9.1 **OVERARCHING PHILOSOPHY OF THE UNIFORM PRINCIPAL AND INCOME ACT (CHAPTER 117)**. According to the Prefatory Note to the Prudent Investor Act, that Act made five basic changes detailed below. However, the five changes do not encompass what I perceive to be the most important overall change in approach – the trustee must look to the terms of the trust it is administering and all decisions must be made in light of the specific trust. Contrast this with the old Prudent Man Rule which was somewhat mechanical in its operations and could be applied to all trusts. Now, investment decisions must be based on the trust, and a trustee will be required to demonstrate that it considered the factors in Tex. Trust Code §117.004 with respect to each trust under administration.

9.2 **FIVE CHANGES MADE BY PRUDENT INVESTOR**

9.2.1 **Total Portfolio Test.** "The standard of prudence is applied to any investment as part of the total portfolio, rather than to individual investments. In the trust setting, the term 'portfolio' embraces all the trust's assets." [§117.004(b)]

9.2.2 **Risk.** "The tradeoff in all investing between risk and return is identified as the fiduciary's central consideration." The trustee must consider the risk tolerance level in light of the trust and its beneficiaries. Risk is minimized through diversification, the twin pillars of modern portfolio theory. [§117.004(b)]

9.2.3 **No restrictions on investments.** "All categoric restrictions on types of investments have been abrogated; the trustee can invest in anything that plays an appropriate role in achieving the risk/return objectives of the trust and that meets the other requirements of prudent investing." Thus, there is now no such thing as an "approved list" for trust investments. Some trusts should have derivatives, hedge funds and other speculative investments in their portfolio. Because of this new freedom (and responsibility) the ability to delegate becomes important as discussed below. [§117.004(e)]

9.2.4 **Diversification.** "The long familiar requirement that fiduciaries diversify their investments has been integrated into the definition of prudent investing." (§117.005)

9.2.5 **Delegation.** "The much criticized former rule of trust law forbidding the trustee to delegate investment and management functions has been reversed. Delegation is now permitted subject to safeguards." From a litigation standpoint, this is a significant change, because the trustee is absolved from liability for the actions of its agent if the statute is complied with. And the real question is: "Is there a duty to delegate.

9.2.5.1 It will be very difficult for an individual trustee to carry out his or her investment functions properly in the complex financial markets that exist today. Thus, an individual might have a duty to delegate some or all of the investment functions to professionals. Additionally, with the complexity brought on by

the Uniform Principal and Income Act, should an individual trustee delegate the allocation between principal and income.

9.2.5.2 A corporate trustee (unless very large) probably does not have investment expertise in market niches (*e.g.*, foreign markets) in which the trust should be invested. Here again, there may be a duty to delegate so that the trust is properly invested.

9.3 **POWER OF ADJUSTMENT UNDER UNIFORM PRINCIPAL AND INCOME ACT**. The most controversial provision of the Principal and Income Act is the ability of the trustee to reallocate receipts between principal and income. Note that this ability runs both ways, from principal to income and *vice-versa*, although in this environment it is thought of as a way to increase the distribution for an income beneficiary.

9.3.1 **Failure to Exercise.** Failure to exercise this power is not a breach of trust unless such failure is an abuse of discretion. [Tex. Trust Code §116.006 (a)]. However, the failure to even consider its exercise is a failure to exercise discretion.

9.3.2 **Exercise.** As with the failure to exercise, whether there is a breach of trust in the exercise of the power is measured by an abuse of discretion standard.

9.3.3 **Damages.** If the trustee is found to have breached its duty, then the beneficiaries are first made whole from the trust; *i.e.*, (i) if there is an over distribution of income, amounts are withheld from future distributions; (ii) if there is an under distribution the distributions are caught up; and (ii) if neither of those or possible, the trustee comes out of pocket to make it right. [Tex. Trust Code §116.006(c)]

9.3.4 **Request for Instructions.** Texas departs from the Uniform Act in §116.006(d), by allowing the trustee to seek court approval of the exercise of the power to adjust only "if the trustee believes that one or more beneficiaries of such trust will object to the manner in which the trustee intends to exercise or not exercise the power [to adjust]." The failure of a beneficiary to give the beneficiary's consent, standing alone, is not a reasonable basis to believe that the beneficiary will object.

10 GENERAL OBSERVATIONS ABOUT TRUST LITIGATION PROCEDURES:

10.1 **OVERLAPPING AND CONFLICTING PROCEDURAL RULES:** The Texas Trust Code contains numerous provisions that regulate trust litigation. The Texas Rules of Civil Procedure and The Texas Civil Practice and Remedies Code also regulate litigation generally. There are numerous overlapping and conflicting provisions in these three bodies of lay. There are situations where the Trust Code deals with a litigation issue and one or more of the other sets of rules deal with the same issue in a much more comprehensive manner. As indicated below this can lead to considerable confusion.

Tex. Trust Code §115.012 attempts to deal with this problem by providing that:

> Except as otherwise provided, all actions instituted under this subtitle are governed by the Texas Rules of Civil Procedure and the other statutes and rules that are applicable to civil actions generally.

As will be demonstrated below, It is often very difficult to reconcile these rules.

10.2 **WHAT CONSTITUTES TRUST LITIGATION**: Chapter 115 of the Texas Trust Code contains many of the procedural rules relating to trust litigation. Generally these provisions apply to all proceedings concerning trusts. As previously discussed, trust litigation is an equitable, rather than a legal proceeding. On first glance, it would be hard to imagine a proceeding in which a trustee was a plaintiff or defendant that was not a "proceeding concerning a trust".

These rules and the rules of equity clearly apply to proceedings that most practitioners would consider to clearly be equitable proceedings. These are set forth in Tex. Trust Code §115.001 and would include suits: for breach of fiduciary duty, for the settlement of accounts, for the removal of a trustee, for equitable instructions, for construction of a trust, for the determination of the validity of a trust, for the modification or termination of a trust, to require an accounting, to appoint a trustee or to surcharge a trustee.

These rules and the rules of equity should not apply to proceedings that are clearly legal proceedings. For example, if a trustee were to contract with a third party (who was not a beneficiary of the trust) and the third party was to breach the contract, the trustee's action against the third party, for breach of contract, would probably be governed solely by the Texas Rules of Civil Procedure and other laws relating to breach of contract. The same would be true if the trustee committed a tort against a third party or was injured in the course of his business as trustee by a third party. Notwithstanding the fact that these types of lawsuits do "concern trusts" they are not equitable in nature and should not be governed by the special rules that apply to trusts or equitable proceedings.

Some of these issues may not have been finally resolved. For example, may a trustee bring the breach of contract case described above in a statutory probate court? May a trustee bring the breach of contract case described above in a district court regardless of the amount in controversy? What venue rules apply to this contract case (Texas Civil Practice and Remedies Code venue provisions or Texas Trust Code venue provisions)? Who are the necessary parties in the contract case?

This paper only deals with purely equitable trust litigation. If you are involved in a purely legal proceeding involving a trust the rules and procedures discussed in this paper may not apply to your case.

11 **PROCEDURAL ISSUES**:

11.1 **DISCOVERY CONTROL PLAN**: Texas Rule of Civil Procedure Rule 190.1 provides that:

> Every case must be governed by a discovery control plan as provided in this Rule. A plaintiff must allege **in the first numbered paragraph of the original petition** whether discovery is intended to be conducted under Level 1, 2, or 3 of this Rule.(emphasis added)

The discovery levels are set forth in Rules 190.2 (Level 1), 190.3 (Level 2) and 190.4 (Level 3). The discovery control plan govern the timing and amount of discovery that will be available in the case (such as the total time for oral depositions and the number of interrogatories allowed).

Most complex trust litigation should be conducted under Level 3 which mandates a discovery control plan tailored to the circumstances of the specific suit.

TRCP Rule 190.5 provides that the court may modify a discovery control plan at any time and must do so when the interest of justice requires.

11.2 **JURISDICTION:**

11.2.1 **Tex. Trust Code §115.001**: provides that:

> (a) Except as provided by Subsection (d) of this section, a district court has original and exclusive jurisdiction over all proceedings concerning trusts, **including**[6] proceedings to:

[6] The term "including" is defined in §311.005(13) of the Code Construction Act as follows: "Includes" and "including" are terms of enlargement and not of limitation or exclusive enumeration, and use of the terms does not create a presumption that components not expressed are excluded".

(1) construe a trust instrument;

(2) determine the law applicable to a trust instrument;

(3) appoint or remove a trustee;

(4) determine the powers, responsibilities, duties, and liability of a trustee;

(5) ascertain beneficiaries;

(6) make determinations of fact affecting the administration, distribution, or duration of a trust;

(7) determine a question arising in the administration or distribution of a trust;

(8) relieve a trustee from any or all of the duties, limitations, and restrictions otherwise existing under the terms of the trust instrument or of this subtitle;

(9) require an accounting by a trustee, review trustee fees, and settle interim or final accounts; and

(10) surcharge a trustee.

(b) The district court may exercise the powers of a court of equity in matters pertaining to trusts.

(c) Unless specifically directed by a written order of the court, a proceeding does not result in continuing supervision by the court over the administration of the trust.

(d) The jurisdiction of the district court over proceedings concerning trusts is exclusive except for jurisdiction conferred by law on a statutory probate court or a court that creates a trust under Section 867, Texas Probate Code. (emphasis supplied)

11.2.2 **Tex. Probate Code Ann. §5(e)**, as amended by the 2003 Legislative Session, provides that:

> A statutory probate court has concurrent jurisdiction with the district court, in all personal injury, survival, or wrongful death actions by or against a person in the person's capacity as a personal representative, in **all actions involving an inter vivos trust, in all actions involving a charitable trust**, and in all actions involving a personal representative of an estate in which each other party aligned with the personal representative is not an interested person in that estate. (emphasis supplied)

The term "testamentary trust" was deleted from this section of the Probate Code in the 2003 Legislative Session .

11.2.3 Prior to the 2003 Legislative Session **Tex. Prob. Code Ann. §5A(c):** provided that:

> (c) A statutory probate court has concurrent jurisdiction with the district court in **all actions**:
>
> > (1) by or against a person in the person's capacity as personal representative;
> >
> > (2) involving an inter vivos trust;
> >
> > (3) involving a charitable trust; and
> >
> > (4)Involving a testamentary trust. (emphasis supplied)

11.2.4 This section of the Probate Code was repealed in 2003 Legislative Session.

11.2.5 **Tex. Prob. Code Ann. §5A(e)** provides, in part, that a statutory probate court may exercise its jurisdiction over "the interpretation and administration of testamentary trusts and the applying of constructive trusts". Note that this section does not apply to "all actions" (as was the case in the prior statute) involving testamentary trusts but only actions relating to the interpretation and administration of testamentary trusts.

This section goes on to provide that:

> Except for situations in which the jurisdiction of a statutory probate court is concurrent with that of a district court as provided by Section 5(e) of this Code or any other court, a cause of action appertaining to estates or incident to an estate shall be brought in a statutory probate court.

This language provides that all actions involving an inter vivos trust and a charitable trust may be brought in either the district court or a statutory probate court. It also apparently provides that actions relating to the interpretation and administration of testamentary trusts must be brought in a statutory probate court.

A problem arises in that there are actions contemplated by Texas Trust Code §115.001 that may not be considered actions relating to the interpretation and administration of a testamentary trust. If there are such actions, then this language seems to divest statutory probate courts of jurisdiction over these actions. After all, in 2003 the legislature repealed the provisions of Tex. Probate Code Ann. §5A(c) which granted they jurisdiction over "all actions involving a testamentary trust".

Are there any actions which may not be construed to be "actions relating to the interpretation and administration" of a testamentary trust? Future courts may well determine that the following actions are not "actions involving a testamentary trust":

> (1) actions to modify the terms of a testamentary trust;
>
> (2) actions to remove the trustee of a testamentary trust;
>
> (3) actions to surcharge the trustee of a testamentary trust;
>
> (4) actions to require an accounting of a testamentary trust pursuant to the terms of the Trust Code.

If they do, then trust litigators face a real problem. Cases involving a testamentary trust often involve both actions that must be brought in a statutory probate court pursuant to Texas Trust Code §5A(b) (actions involving the interpretation and administration of testamentary trusts) and actions over which a statutory probate

court does not have jurisdiction (any actions that do not involve the "interpretation and administration" of a testamentary trust).

11.2.6 **Which Court To File In:** In counties that do not have statutory probate courts, proceedings concerning trusts must be brought in the district court. In counties that have statutory probate courts, proceedings concerning trusts may be brought in either a district court or a statutory probate court.

When hearing proceedings concerning trusts, statutory probate courts do not have the extraordinary powers (granted to them pursuant to Tex. Prob. Code Ann. §5B and §608) to reach out and remove cases from other courts.

While most statutory probate judges demonstrate a very high level of expertise when dealing with estate and guardianship cases, they may not have a similar level of expertise when dealing with trust matters.

It is the author's experience that district court judges are much less likely to rely on preconceived knowledge of trust law and are more likely to objectively review and consider legal authority regarding trusts than statutory probate judges. On the other hand, many statutory probate judges have real expertise in trust law which may greatly facilitate the trial of your lawsuit.

The dockets of most statutory probate courts are less crowded than those of most district courts. This is not, however, universally true, the dockets of some district courts are less crowded than those of some statutory probate courts.

11.3 **JURISDICTION OF THE COURT TO SUPERVISE THE ADMINISTRATION OF A TRUST:** In Texas, the administration of trusts is not normally supervised by a court.

Whenever a party files an action invoking the court's jurisdiction pursuant to Tex. Trust Code §115.001 the court automatically acquires the additional jurisdiction to supervise the administration of the trust. This jurisdiction continues throughout the trial of the proceeding before the court. It does not, however, extend beyond the final judgment in such proceeding unless the court by written order specifically extends it.

While this is clearly the law, it is hard to piece together the authority for this jurisdiction due to the very poor wording in the Trust Code. Texas Trust Code §115.0001(c) provides that: "Unless specifically directed by a written order of the court, a proceeding does not result in continuing supervision by the court over the administration of the trust." The meaning of this section is incomprehensible and the provision rendered useless unless interpreted to mean that court administration of a trust is permissible. By implication, and through the express delineation of the powers of a court in §115.0001(a), it is clear that Texas statute authorizes the administration of a trust by a court of appropriate jurisdiction.

Texas Trust Code §115.001(c) was taken from § 7-201(b) of the Uniform Probate Code which provides that:

> Neither registration of a trust nor a proceeding under this section result in continuing supervisory proceedings. The management and distribution of a trust estate, submission of accounts and reports to beneficiaries, payment of trustee's fees and other obligations of a trust, acceptance and change of trusteeship, and other aspects of the administration of a trust shall proceed expeditiously consistent with the terms of the trust, free of judicial intervention and without order, approval or other action of any court, subject to the jurisdiction of the Court as invoked by interested parties or as otherwise exercised as provided by law.

The U.P.C. Manual comments on § 7-201(b) as follows:

> Unless there is a need for review, the administration of the trust should consequently proceed in a businesslike manner without intervention by the court in the costly, supervised practice that now exists under some statutes.
>
> See Uniform Probate Code Practice Manual (2d ed. 1977), Vol. II, page 594.

Once a proper person invokes the court's jurisdiction over a trustee (by filing a proceeding under Texas Trust Code §115.001) then the court obtains the jurisdiction to supervise the administration of the trust during the pendency of the proceeding. In any event, when the §115.001 proceeding is closed, the court loses its jurisdiction to supervise the administration of the trust, unless the court specifically retains this jurisdiction in the order disposing of the §115.001 proceeding. Thus, a court of appropriate jurisdiction is authorized to retain jurisdiction over administration of a trust.

Section 54 of Texas Jurisprudence 3rd on Trusts, is consistent with the common law and the Texas Trust Code addressed above. Specifically, Texas Jurisprudence 3rd on Trusts, Section 54, elucidates that:

> More generally, equity courts have assumed advisory jurisdiction with respect to trust property.....The district court may exercise the powers of a court of equity in matters pertaining to trusts and is given jurisdiction over all proceedings concerning trusts, including, among others, proceedings to construe a trust instrument, to determine the law applicable to a trust instrument, to determine the powers, responsibilities, duties, and liability of a trustee, to make determinations of fact affecting the administration, distribution or duration of a trust, and to determine a questions arising in the administration or distribution of a trust."

In sections 558 through 560 of his treatise on trusts, Professor Bogert addresses "Court Control" over a trustee's mandatory powers (Section 558), "Court Control" in terms of court "advice as to extent of powers" of a trustee (Section 559), and "Court Control" over a trustee's discretionary powers (Section 560). Bogert, *Trusts and Trustees*, 2nd Ed, (2000) Sections 558 - 560. In a nutshell, Bogert reports courts are generally reluctant to exercise control over the administration of a trust, particularly where there is no ambiguity as to the trustee's duties and powers. According to Bogert:

> The court will not advise the trustee as to his powers where they are clearly fixed by the trust instrument or by common or statute law, but only in cases of real difficulty where there is an honest doubt after a careful reading of the instrument and the procurement of legal advice from counsel....There must be a legal problem arising from uncertainty of the settlor's intent or from applicable law." Bogert, Section 559, pp. 175-177.

Bogert continues:

> Further, the Courts refuse to give instructions concerning problems which may never arise, or difficulties which may face the trustee at some future time, since the court does not wish to commit itself until there is real need for action." Bogert, Section 559, at pp.178-179.

In other words, the courts will not give advisory opinions or circumvent a trustee's duty to exercise discretion. The trustee is generally expected to perform the duties ascribed to the trustee, without resorting to the court for insulation of liability for actions taken as trustee.

However, while this general rule of "non-intervention" is recognized and controls in a great many cases, Bogert adds this significant proviso:

> "...equity has established certain limitations on this [non-intervention] doctrine which are deemed to be necessary to prevent the frustration of the settlor's intent and inequitable conduct by the trustee....So, also, if the trustee has gone through the

> formality of using his discretion but has not deliberately considered the arguments pro and con, and thus has made a decision for no reason at all, his conduct can be characterized as arbitrary and capricious, as amounting to a failure to use his discretion, as not in performance of his duty with regard to the discretionary power, and as warranting the court to require a reconsideration by the trustee or some other relief.

Bogert, Section 560, at pp. 194-195.

In furtherance of his discussion of court supervision of trusts, Bogert explains;

> .....Many courts describe the cases where they review and upset the trustee's use of discretionary powers as those involving "an abuse of discretion", "bad faith", "dishonesty", or "arbitrary" action. It is believed that these phrases cover a variety of improper actions, for example acting for the benefit of the trustee himself or some third person, or for the purpose of harming the beneficiary or out of ill will or prejudice against him or an action contrary to the express purposes of the trust." (Emphasis added).
>
> Bogert, Section 560, pp.196-201.

Thus, it is assumed that courts will exercise equitable jurisdiction to supervise trusts, in proper circumstances, just as the common and statutory law of Texas allows.

Texas courts have recognized a court's authority to exercise common law supervisory jurisdiction over the administration of a trust (as well as statutory and secondary authority, which will be discussed further below). The Texas Supreme Court so stated in *State v. Rubion*, 308 S.W.2d 4 (Tex. 1957). In *Rubion*, the State of Texas brought suit against the trustee of a testamentary trust which had been created for the support of a disabled patient at Abilene State Hospital. The State claimed a right to reimbursement for the money it expended for the patient's care, and the Supreme Court analyzed the nature of the trust, in terms of whether it was a spendthrift trust or had the characteristics of a support trust. After determining the trust to be available for the support of the patient, the Court went further to examine the trustee's discretion to determine "how much of the trust property shall be made available for the support of the beneficiary." The Court stated that the trustee's discretion is not unbridled, and "discretion must be reasonably exercised to accomplish the purposes of the trust according to the settlor's intention and his exercise thereof is subject to judicial review and control." . Thus the Texas Supreme Court has acknowledged the authority of a court to exercise its supervisory jurisdiction over the administration of a trust. See also, *Rekdahl v. Long*, 407 S.W.2d 339 (Tex.Civ.App.–Eastland, aff'd 417 S.W.2d 387 1967)(court exercises jurisdiction over monthly distributions from trust).

The Beaumont Court of Appeals has also recognized a trial court's exercise of its jurisdiction to administer the trust in question. In *American National Bank of Beaumont v. Biggs*, 274 S.W.2d 209 (Tex.Civ.App.–Beaumont 1954, writ ref'd n.r.e.), the dispute was over the payment of legal fees incurred by the trustees in a prior separate suit to defend their actions in making allocation of oil and gas royalties to the principal or income accounts of the trust. The trustees were also remaindermen of the trust, so they were accused of self-dealing in making their allocation. Specifically, the Court of Appeals described the separate case thus; it "involved past conduct of the trustees and threatened future conduct of the same sort, the depletion of a fund and its diversion from one class of beneficiaries to another."

After the separate litigation was concluded, the trustees in *Biggs* presented a claim for their legal fees to the trial court ex parte, and the beneficiaries complained on appeal that they should have had notice and the opportunity to be heard. The *Biggs* Court saw no abuse of discretion by the trial court in conducting the ex parte hearing, as "....The proceeding [the ex parte hearing] was not an independent suit but seems to have been only the presentation of a claim to a court engaged in administering a trust. (Emphasis added)" *Biggs*, 274 S.W.2d at 225. Likewise, the Court noted that the trial court order regarding the claim "contains statements which indicate that the trial court had

taken over the administration of the trust estate, and there is nothing to show that anybody has objected to this action." *Id.* Finally, in determining the effect of the court's order which was entered after the ex parte hearing, the *Biggs* Court stated: "What effect, then, did the order of July 14th have? *Seawall v. Greenway*, 22 Tex. 691, decided at the Galveston term in 1859, was an instance of the administration of a trust by the district court. There the trust was for the benefit of creditors, but the court was exercising the powers of a court of equity and was not proceeding under a statute." Clearly then, the case law in Texas has long held that Courts have the equitable jurisdiction to administer a trust.

11.4 **VENUE:**

11.4.1 **Tex. Trust Code § 115.002:** provides that:

> (a) The venue of an action under Section 115.001 of this Act is determined according to this section.
>
> (b) If there is a single, noncorporate trustee, an action shall be brought in the county in which:
>
> > (1) the trustee resides or has resided at any time during the four-year period preceding the date the action is filed; or
> >
> > (2) the situs of administration of the trust is maintained or has been maintained at any time during the four-year period preceding the date the action is filed.
>
> (c) If there are multiple trustees or a corporate trustee, an action shall be brought in the county in which the situs of administration of the trust is maintained or has been maintained at any time during the four-year period preceding the date the action is filed, provided that an action against a corporate trustee as defendant may be brought in the county in which the corporate trustee maintains its principal office in this state.
>
> (d) For just and reasonable cause, including the location of the records and the convenience of the parties and witnesses, the court may transfer an action from a county of proper venue under this section to another county of proper venue:
>
> > (1) on motion of a defendant or joined party, filed concurrently with or before the filing of the answer or other initial responsive pleading, and served in accordance with law; or
> >
> > (2) on motion of an intervening party, filed not later than the 20th day after the court signs the order allowing the intervention, and served in accordance with law.
>
> (e) Notwithstanding any other provision of this section, on agreement by all parties the court may transfer an action from a county of proper venue under this section to any other county.
>
> (f) For the purposes of this section:
>
> > (1) "Corporate Trustee" means an entity organized as a financial institution or a corporation with the authority to act in a fiduciary capacity.

> (2) "Principal office" means an office of a corporate trustee in this state where the decision makers for the corporate trustee within this state conduct the daily affairs of the corporate trustee. The mere presence of an agent or representative of the corporate trustee does not establish a principal office. The principal office of the corporate trustee may also be but is not necessarily the same as the situs of administration of the trust.
>
> (3) "Situs of administration" means the location in this state where the trustee maintains the office that is primarily responsible for dealing with the settlor and beneficiaries of the trust. The situs of administration may also be but is not necessarily the same as the principal office of the trustee.

11.4.2 **Has The Action Been Brought Under Tex. Trust Code §115.001?** The character of a case with respect to the application of our venue statute must be determined by the facts alleged, the rights asserted thereunder and the relief prayed for in the party's pleadings. *Shellberg v. Shellberg*, 428 S.W.2d 117 (Tex. App. – Ft Worth 1968); *Hooser v. Forbes*, 33 S.W.2d 550 (Tex.Civ.App.– 1930, no writ history); *Gifford-Hill & Co. v. Hearne Sand & Gravel Co.*, 183 S.W.2d 766 (Tex. Civ. App., 1944, no writ hist.) The court in *Shellberg* examined the pleadings in their entirety in an attempt to find out what principal right or rights are asserted and what relief is sought.

11.4.3 **Tex. Property Code §123.005 (a):** provides that:

> (a) Venue in a proceeding brought by the attorney general alleging breach of a fiduciary duty by a fiduciary or managerial agent of a charitable trust shall be a court of competent jurisdiction in Travis County or in the county where the defendant resides or has its principal office.

11.4.4 **General Observations:** The general venue rules are contained in Chapter 15 of the Texas Civil Practice & Remedies Code (the "CPRC"). This is often confusing because of similarity of the section numbers to the Texas Trust Code section relating to venue (Tex. Trust Code §115.002). In proceedings brought under Tex. Trust Code §115.001 (all proceedings concerning trusts) the Texas Trust Code provisions control and take precedence over the provisions in the Civil Practice and Remedies Code provisions.

> There are situations, however, where both provisions might be applicable in determining venue. The trust code does not have any provisions relating to multiple party or multiple claim venue. CPRC §15.003 deals with multiple party plaintiffs; CPRC §15.004 deals with multiple claims; and CPRC §15.005 deals with multiple defendants. To further complicate the problem, there are situations involving multiple party and multiple claim issues where the mandatory venue provisions of the Trust Code conflict with those int eh CPRC.

11.4.5 **Initial Venue:** While Tex. Trust Code §115.002 is fairly clear there are portions of this statute that simply do not make sense. Most of these involve situations were there is a successor trustee.

> If A, an individual trustee, resigns, and B, an individual trustee, becomes his successor, then a plaintiff may apparently file a trust action in any county that B has resided in for the past four years even though B did not serve as trustee during this period.
>
> A similar problem relates to the situs of the trust. If A, a corporate trustee resigns, and B a corporate trustee becomes A's successor, then the situs of the trust would be

the county where A (who man not even be a party to the action) maintained the office that was primarily responsible for administering the trust during the preceding four years when A was trustee.

11.4.6 There may be situations where the venue provisions contained in Texas Trust Code §115.002 do not allow you to file in the venue that you desire. In those cases you should consider the possibility of bringing your cause of action, if possible, under the Texas Uniform Declaratory Judgments Act (CPRC Chapter 37) rather than the Texas Trust Code.

The Declaratory Judgment Act allows:

> A "person interested as or through ... a trustee ... or cestui que trust in the administration of a trust" to have a declaration of rights or legal relations in respect to the trust:
>
> (2) to direct the ... trustees to do or abstain from doing any particular act in their fiduciary capacity;
>
> (3) to determine any question arising in the administration of the trust ... including questions of construction of wills and other writings.

Venue for declaratory judgment actions is governed by CPRC Chapter 15 rather than by Texas Trust Code §115.002.

11.4.7 **Contesting Venue:** Texas Rules of Civil Procedure ("TRCP") Rules 86 - 89 deal with motions to transfer venue. These are fairly well established rules that are familiar to most trial lawyers. Tex. Trust Code §115.002 (d) also contain special rules dealing with motions to change venue.

Recall that Tex. Trust Code §115,012 provides that "Except as otherwise provided, all actions instituted under this subtitle are governed by the Texas Rules of Civil Procedure and the other statutes and rules that are applicable to civil actions generally." This trust code provision is not particularly helpful in resolving this issue.

The TRCP contains numerous rules relating to the time to file a motion to transfer venue [Rule 86 (1)]; how to file a motion to transfer venue [Rule 86 (2)]; the requisites of a motion to change venue [Rule 86 (3)]; response and reply [Rule 86 (4); service [Rule 86 (5)]; burden of proof [Rule 87 (2); proof [Rule 87 (3)]; abatement of discovery [Rule 88]. Tex. Trust Code §115.002 (d) contains numerous provisions that conflict with the rules contained in the TRCP and is silent regarding many of the matters contained in the TRCP.

For example, Tex. Trust Code §115.002 (d) provides that for "just and reasonable cause" a court may transfer an action from a county of "proper venue" to another county of "proper venue". The concept of "just and reasonable cause" is not addressed in the TRCP. Under the TRCP, if a claimant has adequately pleaded and made prima facie proof that venue is "proper" in the county of suit then the case may not be transferred regardless of "just and reasonable cause".

Tex. Trust Code §115.002 (d) (1) provides that the motion of a defendant or joined party must be filed concurrently with or before the filing of the answer or other initial responsive pleading, and served in accordance with law. Does this rule require that the motion be a separate instrument from the initial responsive pleading?

The TRCP Rule 86 provides that the motion may be contained in a separate instrument filed concurrently with or prior to the filing of the movant's first responsive pleading or the motion may be combined with other objections and defenses and included in the movant's first responsive pleading and served pursuant to TRCP Rule 21a.

The TRCP Rule 87 (1) specifically provides that, except for leave of court, each party is entitled to at least 45 days notice of a hearing on a motion to transfer. This rule also provides that, except for leave of court, any response or opposing affidavits shall be filed at least 30 days prior to the hearing on the motion to transfer. Do these provisions apply to Tex. Trust Code §115.001 (d) proceedings?
Do the proof requirements set forth in the TRCP apply to Tex. Trust Code §115.002 (d) proceedings? If so, how does the requirement that the movant prove "just and reasonable cause" relate to the TRCP proof requirements.

Some of these conflicts are very subtle others more substantive. The fact remains, however, that the interrelationship between these two bodies of law is far from being reconciled in Texas. Until there is definitive authority, a prudent practitioner should probably use his or her best efforts to reconcile these provisions by applying both bodies of law to the greatest extent possible.

11.5 **PARTIES GENERALLY:**

11.5.1 **A Trust Is Not A Legal Entity That Can Sue or Be Sued:** A trust is not a legal entity that can sue or be sued. *Thompson v. Vinson & Elkins,* 859 S.W.2d 617 (Tex App. – Houston (1st Dist.) August 5, 1993); *Ridge v. Wood,* 140 S.W.2d 536 (Tex. App. – El Paso April 18, 1940). Any legal proceeding concerning a trust must be brought by or against the trustee.

11.5.2 **Standing:**

11.5.2.1 **Tex. Trust Code §115.011:** provides that:

> (a) Any **interested person** may bring an action under Section 115.001 of this Act. (emphasis supplied) ...
>
> (d) A beneficiary of a trust may intervene and contest the right of the plaintiff to recover in an action against the trustee as representative of the trust for a tort committed in the course of the trustee's administration or on a contract executed by the trustee.

11.5.2.2 **Tex. Trust Code §111.004:** defines a "interested person" to mean:

> a trustee, beneficiary, or any other person having an interest in or a claim against the trust or any person who is affected by the administration of the trust. Whether a person, excluding a trustee or named beneficiary, is an interested person may vary from time to time and must be determined according to the particular purposes of and matter involved in any proceeding.

11.5.2.3 **Tex. Property Code §123.002:** provides that:

> For and on behalf of the interest of the general public of this state in charitable trusts, the attorney general is a proper party and may intervene in a proceeding involving a charitable trust. The attorney general may join and enter

> into a compromise, settlement agreement, contract or judgment relating to a proceeding involving a charitable trust.

11.5.2.4 **Texas Rule of Civil Procedure Rule 44:** provides that:

> Minors, lunatics, idiots, or persons non compos mentis who have no legal guardian may sue and be represented by "next friend" under the following rules:
>
> > (1) Such next friend shall have the same rights concerning such suits as guardians have, but shall give security for costs, or affidavits in lieu thereof, when required.
> >
> > (2) Such next friend or his attorney of record may with the approval of the court compromise suits and agree to judgments, and such judgments, agreements and compromises, when approved by the court, shall be forever binding and conclusive on the party plaintiff in such suit.

It is fairly commonplace for trust litigation to be instituted by a "next friend" on behalf of an incapacitated beneficiary.

TRCP Rule 173 authorizes the appointment of a guardian ad litem only when it appears that the next friend has an interest that is adverse to the person represented. *Davenport v. Garcia,* 834 S.W.2d 4, 24 (Tex. 1922; *Newman v. King,* 433 S.W.2d 420, 421 - 22 (Tex. 1968). If the court determines that a conflict exists, the court must appoint a guardian ad litem. *Jaynes v. Lee,* 306 S.W.2d 182, 185 (Tex.Civ. App. - Texarkana 1957, no writ). Once appointed, the guardian ad litem displaces the next friend and becomes the personal representative of the individual subject to a legal disability. *Newman* at 421; *Kennedy v. Missouri Pac. R.R.,*778 S.W.2d 552 (Tex. App. - Beaumont 1989, writ dismissed).

Tex. Trust Code §115.014 authorizes the appointment of a guardian ad litem " only when the court determines that "the representation of the interest otherwise would be inadequate". While the wording is different, the same rules as stated above with reference to TRCP Rule 173 probably apply. The appointment of a guardian ad litem displaces the next friend as the representative of the incapacitated party.

Some judges do not understand these rules and will automatically appoint a guardian ad litem when they receive notice of the petition. If you have filed your lawsuit on behalf of a next friend you will be eliminated from the case ex parte by the judge.

If you are instituting trust litigation on behalf of a next friend you should almost always file the suit in a district court rather than a statutory probate court. A district court judge is far less likely to make an ex parte appointment of a guardian ad litem.

Although statutory probate court procedures vary, you should NEVER file a trust lawsuit on behalf of a next friend in Travis County. The judge of this court routinely appoints guardians ad litem ex parte. This will immediately eliminate your client from the lawsuit.

11.5.3 **Derivative Actions:** The general rule is that only a trustee may prosecute or defend a suit on behalf of a trust. *Carter v. DeJarnatt,* 523 S.W.2d 88 (Tex. Civ. App. – Texarkana 1975, writ ref'd n.r.e.) There is, however an exception to this general rule. If the trustee: (1) will not or can not act, or (2) has a conflict of interest that prevents it from acting, then a beneficiary of the trust may prosecute or defend a cause of action derivatively on behalf of the trustee.

The court in *InterFirst Bank-Houston, N.A. v. Quintana Petroleum Corporation*, 699 S.W.2d 864 (Tex. Civ. App. - Houston [1st Dist.] 1985, writ ref'd n.r.e.) observed that:

> It is only when the trustee cannot or will not enforce the cause of action that he has against the third person that the beneficiary is allowed to enforce it. In such a case, the beneficiary is not acting on a cause of action vested in him, but is acting for the trustee, and the period of the statute of limitations should be computed from the time the trustee acquired his right to sue. The situation of the trustee with regard to competency, and not that of the beneficiary, is controlling as to the tolling of the statute of limitations. *InterFirst Bank-Houston, N.A., v. Quintana Petroleum* Corporation, 699 S.W.2d 874 (Tex. Civ. App.--Houston [1st Dist.] 1985, writ ref'd n.r.e.); 29 Tex. Jur. 2nd *Decedents' Estates § 834 (1983)*; *Frazier v. Wynn,* 472 S.W.2d 750 (Tex. 1971); *`869 Bogert ,supra 92.*

These rules are well established in Texas law and also apply to decedent's estates and guardianships. See, for example, *Chandler v. Welborn,* 294 S.W.2d 801 (Tex. 1956).

11.5.4 **Capacity**:

The capacity in which a person brings or defends a lawsuit for breach of fiduciary duty may have a direct bearing on:

(1) jurisdiction,
(2) venue,

(3) whether the trust estate or the personal estate of the person serving as a trustee is liable for the judgment, and

(4) whether the trustee is authorized to fund the prosecution or defense of the litigation out of the trust estate.

Special attention must therefore be given to whether the person bringing or defending the cause of action is doing so in his individual capacity or in his fiduciary capacity.

An action against a trustee may be brought by a beneficiary, in his individual capacity, against a trustee in it's fiduciary capacity (rather than the trustee's individual capacity). One example of this type of suit would be a suit by a beneficiary against a trustee for not complying with the income distribution standard in the trust. In this type of suit beneficiary, acting individually, is seeking to recover damages for his own account from the trust estate of the trust (rather than seeking recovery from the personal assets of the trustee).

An action against a trustee may also be brought by a beneficiary in his individual capacity against a trustee in the trustee's individual capacity (rather than it's fiduciary capacity). One example of this type of suit would be a suit by a beneficiary against a trustee to recover for his own account income arising from

profits that the trustee personally made as a result of his breach of the fiduciary duty of loyalty. In this type of suit the beneficiary, acting individually, is seeking to recover damages for his own account from the personal assets of the trustee (rather seeking recovery from the trust estate of the trust).

Finally, an action for breach of fiduciary duty may be brought by a beneficiary, in a derivative capacity, against a trustee, in it's individual capacity (rather than in it's fiduciary capacity).In this type of suit the beneficiary, acting derivatively, is seeking recovery on behalf of the trust estate (rather than personally) from the personal assets of the trustee (rather than seeking recovery from the trust estate of the trust).

This distinction was addressed in detail by the court in *Elizondo v. Texas Natural Resource Conservation Commission,* 974 S.W.2d 928 (Tex. App. - Austin August 13, 1998) which adopted the holdings of several other courts dealing with this issue:

> A person who sues or is sued in his official or representative capacity is, in contemplation of law, regarded as a person distinct from the same person in his individual capacity and is a stranger to his rights or liabilities as an individual. It is equally true that a person in his individual capacity is a stranger to his rights and liabilities as a fiduciary or in a representative capacity. *Alexander v. Todman,* 361 F.2d 744, 746 (3d Cir. 1966)
>
> Acts performed by the same person in two different capacities are generally treated as the transactions of two different legal personages. *Bender v. Williamsport Area Sch. Dist.,* 475 U.S. 534, 543-44, 106 S.Ct. 1326, 89 L.Ed.2d 501 (1986)
>
> Where a party sues or is sued in a representative capacity, however, its legal status is regarded as distinct from its position when it operates in an individual capacity. *Airlines Reporting Corp. v. S & N Travel,* Inc., 58 F.3d 857, 862 (2d Cir. 1955)
>
> In the eyes of the law a person who sues or is sued in a representative capacity is distinct from that person in his individual capacity. *Northern Trust Co. v. kBunge Corp.* 899 F.2d 591, 595 (7th Cir. 1990)
>
> William L. McGinnis, the individual, is not the same party as William L. McGinnis, the next friend of Janie Barr's estate and person. *McGinnis v. McGinnis,* 267 S.W.2d 432 (Tex. Civ. App. - San Antonio 1954, no writ)

11.5.5 **Necessary Parties:**

11.5.5.1 **Tex. Trust Code §115.011 (b)**: provides that:

> (b) Contingent beneficiaries designated as a class are not necessary parties to an action under Section 115.001 of this Act. The only necessary parties to such an action are:
>
> (1) a beneficiary on whose act or obligation the action is predicated;
>
> (2) a person designated by name in the instrument creating the trust; and

> (3) a person who is actually receiving distributions from the trust estate at the time the action is filed.
>
> (c) The attorney general shall be given notice of any proceeding involving a charitable trust as provided by Chapter 123 of this code.

11.5.6 **Ad Litems:**

11.5.6.1 **General Observations:** The Texas Trust Code does not contain any provision dealing with the appointment of an attorney ad litem. Tex. Trust Code §115.014 deals with the appointment of a guardian ad litem.

11.5.6.2 **Tex. Trust Code §115.014** provides that:

> (a) At any point in a proceeding a court may appoint a guardian ad litem to represent the interest of a minor, an incapacitated, unborn, or unascertained person, or person whose identity or address is unknown, if the court determines that representation of the interest otherwise would be inadequate. If there is not a conflict of interests, a guardian ad litem may be appointed to represent several persons or interests.
>
> (b) A court shall appoint a guardian ad litem to defend an action under section 114.083 [relating to tort actions brought against the trustee of a trust] of this Act for a beneficiary of the trust who is a minor or who has been adjudged incompetent.

11.5.6.3 **TRCP Rule 173** provides for the appointment of a Guardian Ad Litem and contains similar language to Tex. Trust Code § 115.014. This Rule provides that:

> When a minor, lunatic, idiot or a non-compos mentis may be a defendant to a suit and has no guardian within this State, or where such person is a party to a suit either as plaintiff, defendant or intervenor and is represented by a next friend or guardian who appears to the court to have and interest adverse to such minor, lunatic, idiot, or non-compos mentis, the court shall appoint a guardian ad litem for such person and shall allow him a reasonable fee for his services to be taxed as part of the costs.

While Rule 173 is probably not applicable to trust cases because of the more specific provisions of Tex. Trust Code §115.064 , it is helpful in respect to the analysis contained below. There are no cases annotated under Tex. Trust Code §115.064 that address the issues set forth below. The author's opinions on these issues is based on his belief that Tex. Trust Code §115.064 creates the same type of guardian ad litem as TRCP Rule 173. There are numerous cases dealing with the role of a guardian ad litem under Rule 173.

11.5.6.4 **Duties of Guardian Ad Litem:** A guardian ad litem in a trust probably acts as the **personal representative** of the minor, incapacitated, unborn, unascertained person, or person who'd identity or address is unknown **rather than as an extension or instrumentality of the court**. This status is important in determining the powers and duties of the guardian. For an excellent discussion of this distinction in the context of TRCP Rule 173 see *Byrd v. Woodruff*, 891 S.W.2d 689 (Tex. Civ. App. – Dallas 1994) see also *Delcourt v. Silverman*, 919 S.W.2d 777 (Tex. Civ. App. – Houston [14th Dist.] 1996).

Generally case law limits an ad litem's powers (and duties) to matters connected with the suit in which he is appointed, and the ad litem's powers end when a judgment is entered. See *Byrd at* 705.

Because an ad litem acts as a beneficiary's personal representative, the ad litem does not have judicial immunity and may be sued. See *Byrd* at 707 - 708.

The ad litem acts not as an attorney for the beneficiary but as the beneficiary's personal representative. As such, the ad litem is a fiduciary.

As a fiduciary, the ad litem has the fiduciary duties to: (1) use the skill and prudence that an ordinary, capable, and careful person would use in the conduct of his own affairs; (2) use diligence and discretion in representing the beneficiary's interests, and (3) be loyal to the beneficiary. See *Byrd* at 706 -707

In the context of litigation an ad litem's fiduciary duties would require him to (1) conduct an independent investigation, evaluate the benefits of settling; (2) if necessary prosecute the beneficiary's interests in the lawsuit; (3) determine the best interests of the beneficiary and (4) communicate, as the beneficiary's personal representative, his recommendations to the court. An ad litem has considerable latitude in determining what depositions, hearings, conferences, or other activities are necessary to fulfill these duties.

A guardian appointed under Tex. Trust Code § 114.064 is not an agent of the court and has no delegated authority to act on behalf of the court. The ad litem acts independently of court control. Absent removing an ad litem the court probably has no discretion to control his actions. See *McGough v. First Court of Appeals,* 842 S.W.2d 637, 640 (Tex. 1992)

11.5.6.5 **Ability of A Guardian Ad Litem To Retain Counsel:** Because of the fact that a guardian ad litem acts as the personal representative for a beneficiary and because of the fact that a guardian ad litem does not have judicial immunity, the ad litem should be allowed to retain legal counsel to represent him in connection with the litigation in which he is involved.

11.5.6.6 **Guardian's Fees Taxed As Costs:** TRCP Rule 173 provides that the court may allow an ad litem a reasonable fee for his services to be taxed as part of the costs of the case. Tex. Trust Code §115.014 does not mention either fees or costs. Notwithstanding this fact, a court may surely grant an ad litem in a trust case his fees and they will surely be taxed as costs in the case.

Likewise, a court should be able to allow an ad litem to retain legal counsel, pay the legal counsel as part of the ad litem's fees and charge such amounts as costs of the case.

11.6 CITATION AND NOTICE:

11.6.1 **Tex. Prob. Code Ann. §115.016** provides that:

(a) If notice of a hearing on a motion or other proceeding is required, the notice may be given in the manner prescribed by law or the Texas Rules of Civil Procedure, or alternatively, notice may be given to any party or to his attorney if the party has appeared by attorney or requested that notice be sent to his attorney.

> (b) If the address or identity of a party is not known and cannot be ascertained with reasonable diligence, on order of the court notice may be given by publishing a copy of the notice at least three times in a newspaper having general circulation in the county where the hearing is to be held. The first publication of the notice must be at least 10 days before the time set for the hearing. If there is no newspaper of general circulation in the county where the hearing is to be held, the publication shall be made in a newspaper of general circulation in an adjoining county.

11.6.2 **Tex. Prob. Code Ann. §115.017** provides that:

> A person, including a guardian of the estate, guardian ad litem, or other fiduciary may waive notice by a writing signed by the person or his attorney and filed in the proceedings.

11.6.3 **Citation: TRCP Rule 99 - Rule 124:** These rules deal with the issuance of citation upon the filing of a petition. The rules with respect to citation in trust litigation are the same as those in other civil litigation and are governed by these rules.

11.6.4 **TRCP Rules 21 and 21a:** These rules apply to the filing and serving of pleadings and motions in trust litigation in the same manner that they apply to other civil cases.

TRCP Rule 21 provides that:

> Every pleading, plea, motion or application to the court for an order, whether in the form of a motion, plea or other form of request, unless presented during a hearing or trial, shall be filed with the clerk of the court in writing, shall state the grounds therefor, shall set forth the relief or order sought, and at the same time a true copy shall be served on all other parties, and shall be noted on the docket.
>
> An application to the court for an order and notice of any hearing thereon, not presented during a hearing or trial, shall be served on all other parties not less than three days before the time specified for the hearing unless otherwise provided by these rules of shortened by the court.
>
> If there is more than one party represented by different attorneys, one copy of such pleading shall be delivered or mailed to each attorney in charge.
>
> The party or attorney of record, shall certify to the court compliance with this rule in writing over signature on the filed pleading, plea, motion or application.

TRCP Rule 21a. provides that:

> Every notice required by these rules, and every pleading, plea, motion, or other form of request required to be served under Rule 21, other than the citation to be served upon the filing of a cause of action and except as otherwise expressly provided in these rules, may be served by delivering a copy to the party to be served, or the party's duly authorized agent or attorney of record, as the case may be, either in person or by agent or by courier receipted delivery or by certified or registered mail, to the parties last known address, or by telephonic document transfer to the recipient's current telecopier

number, or by such other manner as the court in its discretion may direct. Service by mail shall be complete upon deposit of the paper, enclosed in a postpaid, properly addressed wrapper, in a post office or official depository under the care and custody of the United States Postal Service. Service by telephonic document transfer after 5:00 p.m. local time of the recipient shall be deemed served on the following day. Whenever a party has the right or is required to do some act within a prescribed period after the service of a notice or other paper upon him and the notice or paper is served upon by mail or by telephonic document transfer, three days shall be added to the prescribed period. Notice may be served by a party to the suit, an attorney of record, as sheriff or constable, or by any other person competent to testify. the party or attorney of record shall certify to the court compliance with this rule in writing over signature and on the filed instrument. A certificate by a party or an attorney of record, or the return of an officer, or the affidavit of any person showing service of a notice shall be prima facie evidence to the fact of service. ;:Nothing herein shall preclude any party from offering proof that the notice or instrument was not received, or, if service was by mail, that it was not received within three days from the date of deposit in a post office or official depository under the care and custody of the United States postal Service, and upon so finding, the court may extend the time for taking the action required of such party or grant such other relief as its deems just. The provisions hereof relating to the method of service of notice are cumulative of all other methods of service prescribed by these rules.

11.6.5 **Tex. Trust Code §115.013:**

(a) Actions and proceedings involving trusts are governed by this section.

(b) An affected interest shall be described in pleadings that give reasonable information to an owner by name or class, by reference to the instrument creating the interest, or in other appropriate manner.

(c) A person is bound by an order binding another in the following cases:

(1) an order binding the sole holder or all coholders of a power of revocation or a presently exercisable general power of appointment, including one in the form of a power of amendment, binds other personas to the extent their interests, as objects, takers in default, or otherwise are subject to the power;

(2) to the extent there is no conflict of interest between them or among persons represented:

(A) an order binding a guardian of the estate or a guardian ad litem binds the ward; and

(B) an order binding a trustee binds beneficiaries of the trust in proceedings to review the acts or accounts of a prior fiduciary and in proceedings involving creditors or other third parties;

> (3) if there is no conflict of interest and no guardian of the estate or guardian ad litem has been appointed, a parent may represent his minor child as guardian ad litem or as next friend; and
>
> (4) an unborn or unascertained person who is not otherwise represented is bound by an order to the extent his interest is adequately represented by another party having a substantially identical interest in the proceeding.
>
> (d) Notice under Section 115.014 of this Act shall be given either to a person who will be bound by the judgment or to one who can bind that person under this section, and notice may be given to both. Notice may be given to unborn or unascertained persons who are not represented under Subdivision (1) or (2) of Subsection (c) by giving notice to all known persons whose interests in the proceedings are substantially identical to those of the unborn or unascertained persons.

11.6.6 **Texas Property Code §123.003** deals with charitable trusts and provides that:

> (a) Any party initiating a proceeding involving a charitable trust shall give notice of the proceeding to the attorney general by sending to the attorney general, by registered or certified mail, a true copy of the petition or other instrument initiating the proceeding involving a charitable trust within 30 days of the filing of such petition or other instrument, but no less than 10 days prior to a hearing in such a proceeding.
>
> (b) Notice shall be given to the attorney general of any pleading which adds new causes of action or additional parties to a proceeding involving a charitable trust in which the attorney general has previously waived participation or in which the attorney general has otherwise failed to intervene. Notice shall be given by sending to the attorney general by registered or certified mail a true copy of the pleading within 30 days of the filing of the pleading, but no less than 10 days prior to a hearing in the proceeding.
>
> (c) The party or party's attorney shall execute and file in the proceeding an affidavit stating the facts of the notice and shall attach to the affidavit the customary postal receipts signed by the attorney general or an assistant attorney general.

For the purpose of this statute the term "charitable trust" means a charitable entity, a trust the stated purpose of which is to benefit a charitable entity, or an inter vivos or testamentary gift to a charitable entity. The term "proceeding involving a charitable trust" means a suit or other judicial proceeding the object of which is to: (1) terminate a charitable trust; (2) depart from the objects of the charitable trust stated in the instrument creating the trust, including a proceeding in which the doctrine of cy-pres is invoked; (3) construe, nullify, or impair the provisions of a testamentary or other instrument creating or affecting a charitable trust; (4) contest or set aside the probate of an alleged will under which money, property, or another thing of value is given for charitable purposes; (5) allow a charitable trust to contest of set aside the probate of an alleged will; (6) determine matters relating to the probate and administration of an estate involving a charitable trust; or (7) obtain a declaratory judgment involving a charitable trust.

11.6.7 **Texas Property Code Ann. §123.004** provides that:

> (a) A judgment in a proceeding involving a charitable trust is voidable if the attorney general is not given notice of the proceeding as required by this chapter. On motion of the attorney general after the judgment is rendered, the judgment shall be set aside.
>
> (b) A compromise, settlement agreement, contract, or judgment relating to a proceeding involving a charitable trust is voidable on motion of the attorney general if the attorney general is not given notice by this chapter unless the attorney general has:
>
> (1) declined in writing to be a party to the proceeding; or
>
> (2) approved and joined in the compromise, settlement agreement, contract or judgment.

11.6.8 **Tex. Trust Code §115.015** provides that:

> (a) A court may not render judgment in favor of a plaintiff in an action on a contract executed by the trustee or in an action against the trustee as representative of the trust for a tort committed in the course of the trustee's administration unless the plaintiff proves that before the 31st day after the date the action began or within any other period fixed by the court that is more than 30 days before the date of the judgment, the plaintiff gave notice of the existence and nature of the action to:
>
> (1) each beneficiary known to the trustee who then had a present or contingent interest; or
>
> (2) in an action on a contract involving a charitable trust, the attorney general and any corporation that is a beneficiary or agency in the performance of such trust.
>
> (b) The plaintiff shall give the notice required by Subsection (a) of this section by registered mail or by certified mail, return receipt requested, addressed to the party to be notified at the party's last known address. The trustee shall give the plaintiff a list of the beneficiaries or persons having an interest in the trust estate and their addresses, if known to the trustee, before the 11th day after the date the plaintiff makes a written request for the information.
>
> (c) The plaintiff satisfies the notice requirements of this section by notifying the persons on the list provided by the trustee.

12 **PARTY LIABILITY:**

12.1 **AD LITEM**: A guardian ad litem participates in the trust proceedings not as an attorney for the designated person but as the personal representative of such person. The ad litem is not an attorney for the designated person and can not be held liable for legal malpractice. See *Byrd* at 710.

12.2 The ad litem is, however, a fiduciary and may be held liable for breach of fiduciary duty. *Byrd* at 706.

12.3 **BENEFICIARY**:

12.3.1 **Tex. Trust Code §114.031** provides that:

> (a) A beneficiary is liable for loss to the trust if the beneficiary has:
>
> > (1) misappropriated or otherwise wrongfully dealt with the trust property;
> >
> > (2) expressly consented to, participated in, or agreed with the trustee to be liable for a breach of trust committed by the trustee;
> >
> > (3) failed to repay an advance or loan of trust funds;
> >
> > (4) failed to repay a distribution or disbursement from the trust in excess of that to which the beneficiary is entitled;
> >
> > (5) breached a contract to pay money or deliver property to the trustee to be held by the trustee as part of the trust.
>
> (b) Unless the terms of the trust provide otherwise, the trustee is authorized to offset a liability of the beneficiary of the trust estate against the beneficiary's interest in the trust estate, regardless of a spendthrift provision in the trust.

12.3.2 **Tex. Trust Code §114.032** provides that:

> (a) A written agreement between a trustee and a beneficiary, including a release, consent, or other agreement relating to a trustee's duty, power, responsibility, restriction, or liability is final and binding on the beneficiary and any person represented by a beneficiary as provided by this section if:
>
> > (1) the instrument is singed by the beneficiary;
> >
> > (2) the beneficiary has legal capacity to sign the instrument; and
> >
> > (3) the beneficiary has full knowledge of the circumstances surrounding the agreement.
>
> (b) A written agreement by a beneficiary who has the power to revoke the trust or the power to appoint, including the power to appoint through a power of amendment, the income or principal of the trust to or for the benefit of the beneficiary , the beneficiary's creditors, the beneficiary's estate, or the creditor of the beneficiary's estate is final and binding on any person who takes under the power of appointment or who takes in default if the power of appointment is not executed.
>
> (c) A written instrument is final and binding on a beneficiary who is a minor if:
>
> > (1) the minor's parent, including a parent who is also a trust beneficiary, signs the instrument on behalf of the minor;
> >
> > (2) no conflict of interest exists; and

(3) no guardian, including a guardian ad litem, has been appointed to act on behalf of the minor.

(d) A written instrument is final and binding on an unborn or unascertained beneficiary if a beneficiary who has an interest substantially identical to the interest of the unborn or unascertained beneficiary signs the instrument. For purposes o this subsection, an unborn or unascertained beneficiary has a substantially identical interest only with a trust beneficiary from whom the unborn or unascertained beneficiary descends.

(e) This section does not apply to a written instrument that modifies or terminates a trust in whole or in part unless the instrument is otherwise permitted by law.

12.4 **CO-TRUSTEE**:

12.4.1 **Texas Trust Code § 113.085** provides:

Except as otherwise provided by the trust instrument or by court order:

(1) a power vested in three or more trustees may be exercised by a majority of the trustees; and

(2) if two or more trustees are appointed by a trust instrument and one or more of the trustees die, resign, or are removed, the survivor or survivors may administer the trust and exercise the discretionary powers given to the trustees jointly.

While § 113.085 does not so provide (unless otherwise provided by the trust instrument or court order) a power vested in two trustees may be exercised only by both of the trustees. If there are more than two trustees then, as indicated above, a majority may exercise a power. If the action of the majority of the trustees constitutes a breach of fiduciary duty (rather than a difference of opinion regarding a discretionary decision) then a non-participating co-trustee has a duty to take action against participating co-trustees to preserve and protect the trust estate.

12.4.2 **Restatement (Second) of Trusts, *supra*, § 224** provides that a trustee is not liable to the beneficiary unless he:

(a) participates in a breach of trust committed by his co-trustee; or

(b)improperly delegates the administration of the trust to his co-trustee; or

(c) approves or acquiesces in or conceals a breach of trust committed by his co-trustee; or

(d) by his failure to exercise reasonable care in the administration of the trust has enabled his co-trustee to commit a breach of trust; or

(e) neglects to take proper steps to compel his co-trustee to redress a breach of trust.

12.4.3 **Additional Authority:** For additional discussion regarding the duties and liabilities of Co-Trustee's see *Bogert, supra* §583, § 584, §585, §586, §587, §588, §589, and §590 and *Scott, supra* §224.

12.5 **PRIOR TRUSTEE**:

12.5.1 **Texas Trust Code § 114.002 provides:**

> A successor trustee is liable for a breach of trust of a predecessor only if he knows or should know of a situation constituting a breach of trust committed by the predecessor and the successor trustee:
>
> (1) improperly permits it to continue;
>
> (2) fails to make a reasonable effort to compel the predecessor trustee to deliver the trust property; or
>
> (3) fails to make a reasonable effort to compel a redress of a breach of trust committed by the predecessor trustee.

12.5.2 **Restatement (Second) of Trusts, *supra*, § 223** provides that a successor trustee is liable for breach of trust if he:

> (1) knows or should know of a situation constituting a breach of trust committed by his predecessor and he improperly permits it to continue; or
>
> (2) neglects to take proper steps or compel the predecessor to deliver trust property to him; or
>
> (3) neglects to take proper steps to redress a breach of trust committed by his predecessor.

12.6 **TRUSTEE:**

12.6.1 **Tex. Trust Code §114.001** provides that:

> (a) The trustee is accountable to a beneficiary for the trust property and for any profit made by the trustee through or arising out to the administration of the trust, even though the profit does not result from a breach of trust; provided, however, that the trustee is not required to return to a beneficiary the trustee's compensation as provided by this subtitle, by the terms of the trust instrument, or by a writing delivered to the trustee and signed by all beneficiaries of the trust who have full legal capacity.
>
> (b) The trustee is not liable to the beneficiary for a loss or depreciation in value of the trust property or for a failure to make a profit that does not result from a failure to perform the duties set forth in this subtitle or form any other breach of trust.
>
> (c) A trustee who commits a breach of trust is chargeable with any damages resulting from such breach of trust, including but not limited to:
>
> (1) any loss or depreciation in value of the trust estate as a result of the breach of trust;

(2) any profit made by the trustee through breach of trust;

(3) any profit that would have accrued tot he trust estate if there had been no breach of trust.

(d) The trustee is not liable to the beneficiary for a loss or depreciation in value of the trust property of for acting or failing to act under Section 113.025 or under any other provisions of this subtitle if the action or failure to act relates to compliance with an environmental law and if there is no gross negligence or bad faith on the part of the trustee. The provision of any instrument governing trustee liability does not increase the liability of a trustee as provided by this section unless the settlor expressly makes reference to this subsection.

(e) The trustee has the same protection from liability provided for a fiduciary under 42 U.S.C. 9607(n). `

12.6.2 **Tex. Trust Code §114.0821** provides that:

Although trust property is held by the trustee without identifying the trust or its beneficiaries, the trust property is not liable to satisfy the personal obligations of the trustee.

12.6.3 **Tex. Trust Code §114.083** provides that:

(a) A personal liability of a trustee or a predecessor trustee for a tort committed in the course of administration of the trust may be collected from the trust property if the trustee is sued in a representative capacity and the court finds that:

(1) the trustee was properly engaged in a business activity for the trust and the trot is a common incident to that kind of activity;

(2) the trustee was property engaged in a business activity for the trust and neither the trustee nor an officer or employee of the trustee is guilty of actionable negligence or intentional misconduct in incurring the liability; or

(3) the tort increased the value of the trust property.

(b) A trust that is liable for the trustee's tort under Subdivision (3) of Subsection (a) is liable only to the extent of the permanent increase in value of the trust property.

(c) A plaintiff in an action against the trustee as the representative of the trust does not have to prove that the trustee could have been reimbursed by the trust if the trustee had paid the claim.

(d) Subject to the rights of exoneration or reimbursement under Section 114.062, the trustee is personally liable for a tort committed by the trustee or by the trustee's agents or employees in the course of their employment.

12.6.4 **Tex. Trust Code §114.084** provides that:

> (a) If a trustee or a predecessor trustee makes a contract that is within his power as trustee and a cause of action arises on the contract, the plaintiff may sue the trustee in his representative capacity, and a judgment rendered in favor of the plaintiff is collectible by execution against the trust property. The Plaintiff may sue the trustee individually if the trustee made the contract and the contract does not exclude the trustee's personal liability.
>
> (b) The addition of "trustee" or "as trustee" after the signature of a trustee who is party to the contract is prima facie evidence of an intent to exclude the trustee from personal liability.
>
> (c) In an action on a contract against the trustee in the trustee's representative capacity the plaintiff does not have to prove that the trustee could have been reimbursed by the trust if the trustee had paid the claim.

12.6.5 **Tex. Trust Code §114.003** provides that:

> If a trust instrument reserves or vests authority in any person to the exclusion of the trustee, including the settlor, an advisory or investment committee, or one or more cotrustees, to direct the making or retention of an investment or to perform any other act in the management or administration of the trust, the excluded trustee or cotrustee is not liable for a loss resulting from the exercise of the authority in regard to the investments, management, or administration of the trust.

12.6.6 **Tex. Trust Code § 114.004** provides that:

> A trustee is not liable for a mistake of fact made before the trust ee has actual knowledge or receives written notice of the happening of any event that determines or affects the distribution of the income or principal of the trust, including marriage, divorce, attainment of a certain age, performance of educational requirements, or death.

12.6.7 **Tex. Trust Code §114.006** provides that:

> (a) A trustee who does not join in exercising a power held by three or more cotrustees is not liable to a beneficiary of the trust or to others for the consequences of the exercise nor is a dissenting trustee liable for the consequences of an act in which the trustee joins at the direction of the majority of the trustees if the trustee expressed the dissent in writing to any of the cotrustees at or before the time of joinder.

12.7 THIRD PARTIES:

12.7.1 Texas Common Law:

The leading case on third party liability is from the Texas Supreme Court. In *Kinzbach Tool Co. v. Corbett-Wallace Corp.*, 160 S.W.2d 509 (Tex. 1942), the Court stated the following with respect to third party liability in Texas:

> It is settled as the law of this State that where a third party knowingly participates in the breach of duty of a fiduciary, such third party becomes a joint tortfeasor with the fiduciary.

See also *Tinney v. Team Bank*, 819 S.W.2d 560, 564 (Tex.App.– Ft. Worth 1991, writ den'd); *Horton v. Robinson*, 776 S.W.2d 260, 266 (Tex.App.–El Paso 1989, no writ.)

12.7.2 **Restatement of Trusts 2nd ,*supra*, §326** provides that:

> A third person who, although not a transferee of trust property, has notice that the trustee is committing a breach of trust and participates therein is liable to the beneficiary for any loss caused by the breach of trust.

12.7.3 **Scott, *Scott on Trusts, supra* §326** provides that:

> **Other Dealings with Trustee**
>
> ....We shall now consider further situation in which the question has arisen whether a third person has so dealt with the trustee as to be chargeable with participation in a breach of trust. If the third person has knowingly assisted the trustee in committing a breach of trust, he is liable for participation in the breach of trust. The more difficult question is how far he is liable where he does not actually know or in fact suspect that the trustee is committing a breach of trust, but where by inquiry he might have learned of the breach of trust. The question is whether and under what circumstances and to what extent the third person is under a duty to inquire as to the authority of the trustee. As in the situations already considered, the answer depends largely on the character of the transaction in which the third person takes part.
>
> **§326.6 General observations**. A trustee or other fiduciary is placed in a situation where there may be a great temptation to pursue his own interest and lose sight of the interest of those for whom he acts. The rules as to the liability of fiduciaries may well be made strict. But a very different question arises as to the liability of third persons dealing with fiduciaries. If third persons knowingly participate with a fiduciary in a breach of his obligations, it is proper to hold them liable. It is quite a different matter, however, to compel them to supervise the conduct of the fiduciary and to hold them liable for failure to do so. A rule imposing such liability on them makes it dangerous to deal with a fiduciary and seriously interferes with the proper performance by the fiduciary of his duties. It is right to require that one who knowingly purchases trust property from a trustee or other fiduciary whose conduct is prima facie wrongful should make a reasonable inquiry, and it is right to hold that he cannot escape liability unless such inquiry would satisfy a reasonable man that the trustee was not committing a breach of trust. If the trustee's conduct is not such as to excite suspicion, still it is held that the purchaser should make inquiry as to his authority to sell. But the rule that purchasers of trust property are bound to see to the application of the purchase money imposed too heavy a burden on purchasers and resulted in such an intolerable obstruction to the administration of trusts that the rule has been generally abolished. The rule that a corporation whose securities are held in trust is bound to investigate whether a transfer of the securities is in breach of trust imposes a heavy burden on corporations and results in a serious obstruction to the

> administration of trusts. Similarly, to the extent that depositories of trust funds, should not be held liable for participation in a breach of trust in the absence of actual knowledge of the breach of trust or conduct amounting to bad faith. Others who have dealings with a trustee should not be bound to supervise the conduct of the trustee and should be liable only if they can fairly be said to have participated in a breach of trust committed by him."

Scott also provides extensive discussion relating to specific third parties dealing with a trustee and their potential liability, based on actual participation, notice, lack of knowledge, duty of inquiry etc. See Scott, §§326.1 - 326.5.

12.7.4 **Special Rules With Respect To Financial Institutions:** In 1911 the Texas Supreme Court in *United States Fid. & Guar. Co. v. Adoue & Lobit***,** 104 Tex. 379; 137 S.W. 648 (Tex. 1911) established a legal principal that is now entrenched in Texas law. This principal is " **if the bank has notice or knowledge that a breach of trust is being committed by an improper withdrawal of funds, ... it will be undoubtedly liable.**"(emphasis supplied)

Liability occurs if the financial institution has notice or knowledge that a breach of trust is being committed by an improper **withdrawal of funds**. If the withdrawal of funds constitutes a breach of trust then the financial institution will be liable even if it had no knowledge of what the fiduciary did with the funds after they were withdrawn. *Wichita Royalty Co. v. City Natl. Bank of Wichita Falls*, 127 Tex. 158; 89 S.W.2d 158 (Tex.1935). In *Wichita* the Court observed that:

> It is not essential to liability on the Bank's part on the theory of participation that it have actual knowledge or for it to have colluded with Peckham to despoil the trust."

The *Wichita* Court also observed that "**It was not necessary, in order to establish participation of the Bank and Harrell, to show actual knowledge on their part of Peckham's purposes as they relate to the various transactions in question**...The Bank and Harrell had constructive knowledge of Peckham's dishonesty, and **inquiry pursued with reasonable diligence** would have disclosed the facts showing Peckham's lack of authority and breaches of trust." (emphasis supplied)

In *Reed v. Valley Fed. S. & L. Co.*, 655 S.W.2d 259 (Tex. App.-Corpus Christi, 1983), the financial institution argued that it because it did not have knowledge of the guardian's actions it could not be held liable. The Court, relying on *Adoue* and *Grebe* rejected this argument.

There is a clear duty on the part of the financial institution to protect the interests of the beneficiary of the fiduciary relationship. In *Grebe v. First State Bank of Bishop*, 136 Tex. 226; 150 S.W.2d 64 (Tex. 1941) the Texas Supreme Court, in applying the Adoue Rule, observed that "Banks are authorized by law to accept deposits, and they are generally used for receiving deposits of various funds for security and safekeeping. **Banks accept accounts like the one in controversy with full knowledge that conditions may arise under the law which call upon them to exercise their judgment to protect the rights of persons interested in such accounts**." (emphasis supplied)

The financial institution will be liable if it has notice or knowledge that a breach of trust is being committed by an improper withdrawal of funds even if the financial institution receives no direct or indirect benefit from the withdrawal of the funds. See *Grebe, supra.*

Once a financial institution has notice or knowledge of the trust character of the funds on deposit then its must independently investigate all applicable legal restrictions governing the use of the funds. See *Grebe, supra.* The Financial Institution may not rely on the fiduciary for this purpose. *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bocock*, 247 F. Supp. 373 (S. D. Tex. 1965). In this case the Court held that "When Bocock furnished the copy of the trust to Merrill Lynch, the question of reliance on his statement ceased. From that time on Merrill Lynch acted, or should have acted, upon the opinion of their legal department."

13 CAUSES OF ACTION:

13.1 BREACH OF FIDUCIARY DUTY/ BREACH OF TRUST:

13.1.1 **Generally:** A trustee is subject to the fiduciary duties set forth above. If a trustee breaches one or more of these duties then the trustee is subject to potential liability for breach of fiduciary duty and commits a "breach of trust".

Texas Courts recognize that courts may grant relief in an equitable proceeding for breach of fiduciary duty. *Risser, supra.*

The elements of breach of fiduciary duty are:

a. the existence of a fiduciary duty,

b. the failure of the trustee to perform it,

c. and proof that the breach of fiduciary duty caused the plaintiff a loss. *Bogert, supra* § 871

There may be overlap between an action for breach of fiduciary and other actions described below. For example, if a trustee's failure to comply with a statutory accounting demand may be a breach of the trustee's fiduciary to account. A trustee's failure to allow a beneficiary access to the books and records of the trust may be a breach of the trustee's duty to disclose. In each of these cases the beneficiary would file a motion to compel the trustee to comply with his common law or statutory fiduciary and would also allege that the trustee breached one or more of his fiduciary duties.

13.1.2 **What Constitutes A Breach Of Trust:**

13.1.2.1 **Generally:** If a trustee breaches or attempts to breach one or more of the fiduciary duties set forth above then he may be prosecuted for breach of fiduciary duty. Generally, lack of knowledge of the existence of the duty, mistake, or failure to consummate an attempted breach will not relieve the trustee from liability. If the trustee receives personal profit from the breach then he may be held liable regardless of whether or not he acted in good faith or whether there was actual damage to the trust estate of the trust.

13.1.2.2 **Restatement of Trusts 2d §201** provides that:

> A breach of trust is a violation by the trustee of any duty which as trustee he owes to the beneficiary.

The commentary under this section provide that:

> a. *Scope of Rule:* Ordinarily a trustee does not commit a breach of trust if he does not intentionally or negligently do what he ought not to do or fail to do what he ought to do. In other words, he does not commit a breach of trust where he

> is not personally at fault, as where he acts under a mistake of law or fact, as is stated in the comments which follow.
>
> b. *Mistake of law as to existence of his duties and powers:* A trustee commits a breach of trust no only where he violates a duty in bad faith, or intentionally although in good faith, or negligently, but also where he violates a duty because of a mistake as to the extent of his duties and powers. This is true not only where his mistake is in regard to a rule of law, whether a statutory or common law rule, but also where he interprets the trust instrument as authorizing him to do acts which the court determines he is not authorized by instrument to do. In such case, he is not protected from liability merely because he acts in good faith, nor is he protected merely because he relies upon the advice of counsel. ... If he is in doubt as to the interpretation of the instrument, he can protect himself by obtaining instructions form the court. The extent of his duties and powers is determined by the trust instrument and the rules of law which are applicable, and not by his own interpretation of the instrument or his own belief as to the rules of law.
>
> c. *Mistake of fact or law in the exercise of powers or performance of duties.* When the question whether the trustee has committed a breach of trust depends not on the extent of his powers and duties, but upon whether he has acted with proper care or caution, the mere fact that he has made a mistake of fact or of law in the exercise of his powers or performance of his duties does not render him liable for breach of trust. In such a case he is liable for breach of trust if he is negligent, but not if he acts with proper care and caution.

Thus, if the trustee is authorized to invest trust funds in such securities as a prudent man would purchase, he is not liable if he invests in bonds which on the facts known to him are the sort in which a prudent man would invest, although, owing to facts which he did not know and was not negligent in not knowing, the bonds were nor tin fact properly secured.

13.1.2.3 **Mistake/Attempted Bre ach:** In *Brault v. Bigham*, 493 S.W.2d 576 (Tex. App. – Waco, March 22, 1973) the court held that:

> A trustee commits a breach of trust not only where he violates a duty in bad faith, or intentionally although in good faith, or negligently, but also where he violates a duty because of a mistake. An intended or attempted appropriation is just as much an indication of danger as though it had been consummated, and hence is a ground for removal.

See also: *Ertel v O'Brien*, 852 S.W.2d 17 (Tex. App. - Waco March 24, 1993)

13.1.2.4 **Good Faith Breach:** In *Beaty v. Bales*, 677 S.W.2d 750 the court held that:

> There is no dispute that a beneficiary is entitled to recovery in a suit against the trustee for breach of a fiduciary duty, even though the beneficiary received no damages and the trustee acted in good faith. *Harvey v. Casebeer*, 531 S.W.2d 206, 207 (Tex. Civ. App. - Tyler 1975, no writ)

13.1.2.5 **Bad Faith Breach:** A finding of bad faith requires some showing of an improper motive and that improper motive is an essential element of bad faith. *InterFirst Bank Dallas, N.A. v. Risser,* 799 S.W2d 882 (Tex. App. – Texarkana 1987); *King v. Swanson*, 291 S.W.2d 773 (Tex. Civ. App. – Eastland, 1956, no. writ); *Ford v. Aetna Insurance Company*, 394 S.W.2d 693 (Tex. Civ. App. - Corpus Christi 1965, writ ref'd n.r.e.)

13.2 **SETTLEMENT OF ACCOUNTS:**

13.2.1 **Texas Trust Code Provisions**: On September 26, 2002, the Texas Supreme Court delivered its second corrected opinion in the case of Texas State Bank v. Amaro, 87 S.W.3d 538 (Tex., Sept. 26, 2002)

> While the opinion deals with numerous trust related issues, a central issue involves a trustee's judicial settlement of its final accounts. While the trust that was the subject of this opinion was a Texas Property Code §142 trust, it is probable that all aspects of this opinion that deal with the judicial settlement of a trustee's final accounts are applicable to other types of trusts. The judicial settlement of a trustee's final accounts is an issue that many trust practitioners have hoped that the Supreme Court would address.
>
> While Tex. Trust Code §115.001 grants Texas courts jurisdiction to "settle interim or final accounts", there is no other provision of the Texas Trust Code that deals in any way with the settlement of a trustee's final accounts. Prior to *Amaro* there was virtually no Texas authority on this issue. While most trustee's were sure that this remedy was available to trustees, they have been perplexed by the lack of Texas authority to support this belief.
>
> *Amaro* resolves numerous issues incident to the settlement of a trustee's final accounts. Unfortunately, it also leaves several significant issues unresolved.
>
> The *Amaro* decision:
>
> 1. Recognized that a trustee may seek a judicial settlement of its final accounts;
>
> 2. Holds that the contents of a final accounting must comply with Tex. Prob. Code Ann. §113.152 (which, by its terms, applies only to accountings that are demanded by a beneficiary or other person interested in a trust);
>
> 3. Probably holds that, in an action to settle a trustee's final account, the court can only discharge a trustee for issues that constituted components of the accounting (rather than other issues such as investment philosophy or potential tort liability which the court determined not to be components of a final accounting);
>
> 4. Holds that a party to a judicial settlement of a trustee's final accounts is not entitled to a jury trial; and
>
> 5. Holds that a party to a judicial settlement of a trustee's final accounts is not entitled to 45 days notice of hearing pursuant to Rule 245 of the Texas Rules of Civil Procedure.

The court's reasoning for these last two holdings raises more questions than it resolves. The court held that "because approval of the accounting ... was not an adjudication of TSB's tort liabilities, Vargas was not entitled to a jury or to forty-five days notice of hearing." Is the rationale behind the court making this distinction the fact that a judicial settlement of a trustee's accounts is a purely equitable proceeding in which jury trials are not traditionally available? If this is in fact the basis for court's ruling, it will be interesting to see how this evolves in later decisions.

The *Amaro* decision left two important issues regarding the judicial settlement of trustee's final accounts undecided. These are:

1. Whether a trustee may recover its attorneys fees and costs incident to the judicial settlement of its final accounts from the trust estate of the trust or whether the trustee must it pay these fees and costs out of its own assets;

2. The exact terms of a judicial discharge in a final accounting action.

It is submitted that a trustee should not be authorized to collect its attorneys fees and costs from the trust estate of the trust if the final accounting is brought simply to obtain a discharge from liability. The only person benefitting from a judicial discharge is the trustee.

The *Amaro* accounting was purportedly brought for the purpose of ascertaining the corpus of the trust that was due to the beneficiaries on termination of the trust. It is submitted that in most instances, a trustee has a fiduciary duty to keep books and records of sufficient accuracy to allow it to determine what should be distributed to the beneficiaries on termination and that the real purpose for a judicial settlement of final accounts is to obtain a discharge for the benefit of the trustee.

While there is *dicta* in *Amaro* that implies that a trustee may not receive a discharge for anything that is not a "component" of the final accounting, the court did not specifically resolve the issue of what type of discharge should be granted to a trustee in this type of proceeding. There is a definite relationship between the trustee's duty to comply with the statutory contents of a final accounting and the trustee's fiduciary duty to disclose that was recognized by the Texas Supreme Court in *Huie v. DeShazo*, 922 S.W.2d 920 (Tex. 1966) and *Montgomery v. Kennedy*, 669 S.W.2d 309 (Tex. 1984). It is the author's opinion that a trustee should only be discharged from liability arising from transactions that are fully and fairly disclosed on the final accounting.

Finally, the *Amaro* court apparently held that, in addition to the settlement of its final accounts, a trustee could utilize the Texas Uniform Declaratory Judgments Act to approve its investment policy and its potential tort liability. This would seem to fly in the face of existing law that the Declaratory Judgments Act may not be utilized to render an advisory opinion. *Bonham State Bank v. Beadle,* 907 S.W.2d 465 (Tex. 1955). While a trustee may seek equitable instruction from a court, Texas law remains unsettled regarding the extent to which the court may give a purely advisory opinion.

Regardless of whether or not it is ever published, the *Amaro* opinion gives insight into the current thinking of the court and perhaps a forecast of how the court will rule if and when these issues are ultimately resolved.

13.2.2 **Texas Trust Code Provisions**: There are no provisions in the Texas Trust Code specifically dealing with the procedures involved in the settlement of a trustee's interim or final accounting. The only reference in the Texas Trust Code to the settlement of interim or final accountings is contained

in Tex. Trust Code § 115.001 (a) (9) which provides that the court has jurisdiction to "require an accounting by a trustee, review trustee fees, and settle interim or final accounts".

13.2.3 **The Commentators:**

13.2.3.1 **The *Restatement of Trusts 2d, supra* §260** provides that:

> The trustee is entitled to have the accounts of his administration of the trust examined and settled by the court.

The comments to this section of the *Restatement* provide that: "The rules determining the effect of the approval by the court of the trustee' s account in barring a beneficiary from thereafter holding the trustee liable for breach of trust are part of the law relating to res judicata and procedure and are not within the scope of this subject.

13.2.3.2 ***Scott, supra* §260**:

> As has been sated, the trustee is under a duty to keep and render accounts with respect to the administration of the trust. The action of the court in approving his accounts may bar the beneficiaries from subsequently surcharging him with respect to matters covered by his accounting. The trustee has a right to insist that his accounts shall be examined and settled by the proper court. The right of the trustee to a settlement of his accounts is of importance to him since the effect is to give him protection against further litigation with respect to matters included in the accounting. The approval of his accounts in a proceeding properly brought gives him the defense of res judicata as to matters within the scope of his accounting. The trustee is not protected, however, if in rendering the account he has been found guilty of fraud or fraudulent concealment. So also the account is not conclusive as to beneficiaries who are not parties to the proceeding. It is ordinarily held that beneficiaries who are under a legal incapacity, or who are not ascertained, or who are yet unborn, can be represented by a guardian ad litem, and if so represented the proceeding is final and conclusive as to them.

13.2.3.3 ***Bogert, supra* §974** provides that:

> ... The court to which the account is presented may reject the account, direct its modification, or approve and settle it. Its approval may conceivably be with leave to file exceptions, but should not be made with the reservation of a right in the beneficiary to charge the trustee for acts or omissions prior to the account, nor should the settlement attempt to dispose of questions of future liability...Obviously the mere filing or presentation of the account does not settle any questions as to the legality of the trustee's acts.
>
> The order, judgment, or decree of approval or settlement is binding on the parties and their privies as to matters covered by the account, both on subsequent accounts and in

collateral proceedings or actions. If no appeal is taken, the same questions cannot be raised again, but the order or decree of approval is not res adjudicata as to matters not raised or disclosed or litigated. An intermediate or annual or interlocutory account and the decree approving it are conclusive as to the matters and questions presented therein in most jurisdictions, but some courts permit matters in such accounts to be reviewed on the final account....
An account which has been settled and approved may be opened by the court which acted upon it, in certain cases, whether upon application of a beneficiary or other interested party, or on the court's own initiative.

The view may be taken that the court has discretion to open up its own decrees whenever necessary to accomplish justice between the parties. If the trustee has been guilty of fraud by way of concealment or misrepresentation in presenting his account and obtaining the approval of the court, the settlement may be opened.

Where the trustee's account does not show facts from which the beneficiary can judge whethe4r there has been self dealing, the courts have been more willing to set its approval aside.

The accounting trustee owes a duty of full disclosure. He should not be allowed to take the position that he is dealing at arm's length with the beneficiary, and that the burden is on the beneficiary to ask questions and seek missing information.

The discovery of new evidence may be ground for opening up of the account, as where a trustee learns of a tax obligation assessed against him after he has accounted and distributed the trust property. The failure to give notice to an interested party may give him the right to have the account opened. ...

If an account is opened up, the trustee may be examined by the court as to the account in question. If an account is opened and corrected to the benefit of the beneficiaries, it would seem that the advantage should be shared by all in proportion to their interests, whether they were influential in bringing about the correction or not.

Examples of various matters and questions held to have been concluded by the approval and settlement of an account or held to remain open for the review are numerous. Thus the determination may have been as to the amount and type of trust principal or income received by the trustee, the persons equitably entitled to interests under the trust and the size of their shares, the fact and propriety of payments made to beneficiaries, the legality of the conduct of the trustee in allocating receipts to principal or income of the trust, the correctness of the allocation of the burden of expenses between life beneficiary and remainderman, the propriety of the acts of the trustee in accepting an investment from the

> executor of the settlor or in making, keeping or selling an investment, the validity of a sale of trust property under an alleged power of sale, the construction of the will under which the trust arose, the allowance of compensation and reimbursement for costs and expenses to the trustee, the question of whether the trustee should be removed, the validity of setting up an accumulation or sinking fund, whether payments to employees or creditors of the trustee were proper, the amount available for distribution and the parties entitled to receive it, the legality of expenditures for improvements, and the liability of the trustee for breach of trust.

13.2.4 **Judicial Settlement Of Accounts Is Extremely Rare In Texas:** Texas courts are rarely asked to settle trustee's accounts for the following reasons:

> (1) Most trustees want to avoid litigation. By filing accounts for judicial review, a trustee is forcing the beneficiaries to assert causes of action against the trustee that they might not otherwise assert if left to their own devices. It is almost a universal truth that defendants (or potential defendants) want to delay litigation as long as possible;
>
> (2) The Judicial settlement of accounts does not really result in a final determination of the trustee's liability. First, the judicial release only applies to facts disclosed in the accounting. A beneficiary does not have a duty to take full discovery to go behind the accounting. Second, a judicial of accounts may be reopened by the court;
>
> (3) Judicial accountings do not bind beneficiaries who do not participate in the accounting action. It is therefore necessary to insure that all parties are before the court. This often requires the appointment of a guardian ad litem. The guardian ad litem may hire legal counsel and further run up the costs of the proceeding;
>
> (4) The question of who pays for a judicial accounting has not been clearly resolved in Texas. A judicial accounting is for the primary benefit of the trustee. A judicial accounting forces a beneficiary to retain legal counsel and participate in a legal process that he or she did not institute. A good argument can be made that all legal fees and costs of a judicial accounting should be borne by the trustee in its individual capacity (rather than by the trust estate of the trust); and
>
> (5) Texas courts do not normally supervise the administration of trusts. They do not have experience in the settlement of accounts. For this reason they are very reluctant to take an active role in the settlement of a trustee's accounts.

13.3 **STATUTORY ACCOUNTING:**

13.3.1 **Tex. Trust Code Ann. §113.151** governs demands for trust accountings. This section provides that:

> (a) A beneficiary by written demand may request the trustee to deliver to each beneficiary of the trust a written statement of accounts covering all transactions since the last accounting or since the creation of the trust, whichever is later.... However, the trustee is not obligated or required to account to the beneficiaries of a trust more frequently than once every 12 months unless a more frequent accounting is required by the court.

> (b) An interested person may file suit to compel the trustee to account to the interested person. The court may require the trustee to deliver a written statement of account to the interested person on finding that the nature of the interest in the trust of, the claim against the trust by, or the effect of the administration of the trust on the interested person is sufficient to require an accounting by the trustee.

There are two different procedures to seek a statutory accounting. Tex. Trust Code §113.151(a) proceedings deal with demands for accounting by beneficiaries of the trust. Tex. Trust Code §113.151(b) proceedings deal with demands for accounting by a "interested person" who is not a beneficiary of the trust.

13.3.2 **Tex. Trust Code §113.151(a) proceedings:** Tex. Trust Code §113.151(a) is not particularly well drafted. It allows any beneficiary of a trust to seek a statutory accounting (the term "beneficiary" is defined in Tex. Trust Code §111.004 to mean "a person for whose benefit property is held in trust, regardless of the nature of the interest").

If the trustee does not deliver a statement within a 90 days after the date the trustee receives the demand (unless entered by the court) the beneficiary is forced to file suit against the trustee to compel the accounting be delivered to "all beneficiaries of the trust" (rather than just the beneficiary requesting the accounting). The statute then provides that the court may require that the trustee deliver an accounting to "all beneficiaries" on finding that "the nature of the beneficiary's interest is sufficient to require an accounting by the trustee". Apparently, if the court finds that the nature of interest of the beneficiary demanding the accounting is sufficient then the court is obligated to compel an accounting to be made to all of the beneficiaries of the trust.

The only person who has the right to enforce a trust is a beneficiary. Most commentators have concluded that the right to receive an accounting and other information regarding the trust is essential to enable a beneficiary to enforce the trust (See the discussion of the fiduciary duty to disclose, above.) It is therefore difficult to understand how a beneficiary's interest in a trust or the effect of the administration of the trust on the beneficiary could not be sufficient to require an accounting.

Once a lawsuit is filed the Trust Litigation Paradox comes into play. The trustee invariably retains very expensive legal counsel (who is paid out of the trust estate of the trust - which belongs to the beneficiaries rather than the trustee) and defends the motion to compel, often intentionally causing the proceeding to be very expensive and time consuming.

The beneficiary is then forced to pay his legal fees out of his own pocket. The court system will invariably treat this similarly to a litigation discovery dispute and offer very little equitable relief to the beneficiary. If a beneficiary persists, he will ultimately receive an accounting but may not recover any of the attorneys fees that he has spent to gain information to which he had an absolute legal right.

13.3.2.1 **Practice Tips**:

13.3.2.1.1 Specify The Date and Time of Compliance: Because of the recent statutory change I recommend that the demand for an accounting specify that the accounting is due "on or before the 90th day after the date that the trustee receives the demand."

13.3.2.1.2 Specify The Method of Compliance: Demand that compliance with a common law information demand be made by written response to the attorney for

the beneficiary making the demand at a specified address. Demand that compliance with a common law document production request be made at a specified location.

13.3.2.1.3 Special Considerations If The Demand Is Made on Behalf of A "Next Friend" For a Minor or Incapacitated Person: If a demand is made in the capacity of "next friend" for a minor or incapacitated person then consideration should be given to filing an application for instruction regarding the time limits to comply with the demand at the same time that the demand is made. If this is not done then the person can apply to the court for instructions regarding some aspect of the accounting; not name the person demanding the accounting as a party ; and apply for the appointment of a guardian ad litem for the minor or incapacitated person. The court may read the pleading ex parte and appoint a guardian ad litem automatically. The appointment of a guardian ad litem will probably eliminate the standing of the "next friend" to prosecute the accounting action.

13.3.3 **Tex. Trust Code §113.151(b) proceedings:** This section deals with demands by and "interested person" other than the beneficiary of the trust [which is covered by subsection (a)]. "Interested person" is defined by Tex. Trust Code §111.004 to mean "a trustee, beneficiary, or any other person having an interest in or a claim against the trust or any person who is affected by the administration of the trust. Whether a person, excluding a trustee or named beneficiary, is an interested person may vary from time to time and must be determined according to the particular purposes or and matter involved in any proceeding".

13.3.4 **Contents of a Formal Trust Accounting:** Tex. Trust Code Ann. §113.152 provides that the accounting must show that:

> (1) all trust property that has come to the trustee's knowledge or into the trustee's possession and that has not been previously listed or inventoried as property of the trust;
>
> (2) a complete account of receipts, disbursement, and other transactions regarding the trust property for the period covered by the account, including their source and nature, with receipts of principal and income shown separately;
>
> (3) a listing of all property being administered, with an adequate description of each asset;
>
> (4) the cash balance on hand and the name and location of the depository where the balance is kept; and
>
> (5) all known liabilities owed by the trust.

13.3.4.1 **Practice Tip**:

13.3.4.1.1 Incorporate the Statutory Contents of An Accounting Into The Demand: Even if the demand specifically states that it is being made pursuant to Tex. Trust Code Ann. §113.151, my experience has been that few trustees really know what should be reported on a statutory accounting. For this reason, you should include the statutory contents of a formal trust accounting in your demand.

> Banks want to give you their computer generated accountings (which usually do not comply with the statute).
>
> Individuals usually have their personal accountant prepare the statutory trust accounting. Certified Public Accountants usually have no concept of fiduciary accounting principals.

Even with the required statutory contents are included in the accounting demand, there will usually be problems with compliance with Tex. Trust Code Ann. §113.152 (2) dealing with the allocation of receipts and disbursements between the income and principal accounts. See Subchapter D. Texas Trust Code, *Allocation of Principal and Income*.

13.4 **EQUITABLE INSTRUCTION**:

13.4.1 **The Cause of Action:** Perhaps the best explanation of an action for equitable instruction is contained in the holding in *Gamel v. Smith,* 21 S.W. 628 (Tex. Civ. App.-1893) in which the court observed that:

> As Trustees hold the legal title for the benefit of third persons, and as the law forbids them from making any profit to themselves from their management of or dealing with the trust fund, so the law protects them from loss if they act according the law in good faith. And in all cases of doubt as to what the law is, and what their conduct ought to be under it, they are entitled to instruction and direction from the court. Whenever a case occurs which justifies the proceedings, trustees, by a bill setting forth the facts and joining the proper parties, may ask the court for instructions as to their duties under the circumstances in which they or the funds are placed. Such instructions and orders, obtained without collusion or fraud, and followed in good faith, will protect trustees from loss, whatever may be the event. It would be a harsh rule to hold the trustee for an error of the court.

13.4.2 **Restatement of Trusts, 2d §259 provides that:**

> The trustee is entitled to apply to the court for instructions as to the administration of the trust if there si reasonable doubt as to his duties or powers as trustee.

The comments to this section provide that:

> a. The trustee is entitled to instructions of the court in respect to such matters as the proper construction of the trust instrument, the extent of his powers and duties, who are the beneficiaries of the trust, the character and extent of their interests, the allocation or apportionment of receipts and expenditures between principal and income, the persons entitled to the income or to the trust property on the termination of the trust. The costs incurred in the application to the court for instructions are payable out of the trust estate; unless the applications for instructions was plainly unwarranted so that it was improper for the trustee to incur the expense of making the application.
>
> b. The trustee is not entitled to instructions as to his powers duties, unless there is a reasonable doubt as to the extent of his powers or duties.
>
> c. The court will not instruct the trustee as to questions which may never arise or may arise in the future but which have not yet arisen. Thus the court will not instruct the trustee as to the distribution of the trust property before the time for distribution arrives.

d. Where a matter rests within the discretion of the trustee, the court ordinarily will not instruct him how to exercise his discretion.

13.4.3 **Instruction May Conflict With The Terms Of The Trust**: The court may issue instructions that conflict with the express terms of the trust instrument. *Carroll v. Carroll,* 464 S.W.2d 440, (Tex. Civ. App. - Amarillo 1971)

13.4.4 **Limitations on Instruction:** Instructions from the Court under Tex. Trust Code Ann. § 115.001 is not available to a trustee just because he wants them. There must be a doubtful question before he is entitled to such instructions and the trustee runs the risk of having to pay the attorney's fee himself if he has no ground for requesting the instructions. See *American National Bank of Beaumont v. Biggs,* 272 S.W.2d 209 (Tex. Civ. App.-Beaumont, 1954, rehear'g denied) and *Gamel v. Smith,* 21 S.W. 628 (Tex. Civ. App.-1893)

13.4.5 **Level of Controversy**: The level of controversy in a instruction suit probably does not have to be as great as that necessary to obtain a declaratory judgment. A trustee can probably obtain equitable instruction if his powers or duties are ambiguous regardless of whether anyone else objects to the trustee's acts.

13.4.6 **Discretionary Decisions:** A trustee may not, however, seek instruction regarding a purely discretionary decision. Courts will not normally substitute their discretion for that of a trustee. See *Thorman v. Carr,* 412 S.W.2d 45 (Tex. 1967)

13.5 **DECLARATORY JUDGMENT:**

13.5.1 **Tex. Civ. Practice & Rem. Code §37.005**: Chapter 37 of the Texas Civ. Practice and Remedies Code § 37.005 provides that:

> A person interested as or through a . . . trustee . . . other fiduciary . . . or cestui que trust in the administration of a trust . . . may have a declaration of rights or legal relations in respect to the trust. . .
>
> > (1) to ascertain any class of creditors, devisees, legatees, heirs, next of kin or others;
> >
> > (2) to direct the . . . trustees to do or abstain from doing any particular act in their fiduciary capacity; or
> >
> > (3) to determine any question arising in the administration of the trust . . . including the construction of . . . other writings.

13.5.2 **Other Provisions:** Chapter 37 of the Texas Civ. Practice and Remedies Code contains special provisions relating to parties, jury trials, costs and attorneys fees.

13.5.3 **Issue In Controversy**: In order to bring a declaratory judgment action under Chapter 37 of the Texas Civ. Practice and Remedies Code there must be an "issue in controversy." Courts may not make declarations on matters based on speculative, hypothetical or contingent situations. See *Empire Life Insurance Company of America v. Moody,* 584 S.W.2d 855, 857 (Tex. 1979); *Limon v. State of Texas,* 947 S.W.2d 620 (Tex. App. -Austin, 1997)

13.5.4 **Venue:** Note that mandatory venue for a declaratory judgment action under the Texas Civ. Practice and Remedies Code is probably different that the mandatory venue for a petition for instruction under Tex. Trust Code Ann. §115.001.

13.6 **MODIFICATION/TERMINATION:**

13.6.1 **Tex. Trust Code Ann. § 112.054** provides that:

> (a) On the petition of a trustee or a beneficiary, a court may order that the trustee be changed, that the terms of a trust be modified, that the trustee be directed or permitted to do acts that are not authorized or that are forbidden by the terms of the trust, that the trustee be prohibited from performing acts required by the terms of the trust, or that the trust be terminated in whole or in part, if:
>
> > (1) the purposes of the trust have been fulfilled or have become illegal or impossible to fulfill; or
> >
> > (2) because of circumstances not known to or anticipated by the settlor, compliance with the terms of the trust would defeat or substantially impair the accomplishment of the purposes of the trust.
>
> (b) The court shall exercise its discretion to order a modification or termination under Subsection (a) in the manner that conforms as nearly as possible to the intention of the settlor. The court shall consider spendthrift provisions as a factor in making its decision whether to modify or terminate, but the court is not precluded from exercising its discretion to modify or terminate solely because the trust is a spendthrift trust.

13.6.2 **Tex. Trust Code §115.001(8):** Note that this section of the trust code allows the court to "relieve a trustee from any or all of the duties, limitations, and restrictions otherwise existing under the terms of the trust instrument or of this subtitle". Courts may rely on this section to allow the trustee to take action that is expressly prohibited by the trust instrument without requiring any party to make the proof requirements contained in Tex. Trust Code §112.054. See *Carroll, supra.*

13.7 **RECEIVERSHIP:**

13.7.1 **Definition:** A receiver is a disinterested person appointed by the court to receive and preserve property. In a general sense, a receiver represents the court.

13.7.2 **Legal vs Equitable Receiverships** : While a receivership may be granted on either legal or equitable grounds, generally the rules of equity will govern the procedure to be followed by the court. Courts of equity have inherent equitable powers to appoint receivers additionally, the Texas Civil Practice and Remedies Code prescribes legal rules for the appointment of a receiver. Even if a receivership is sought on purely equitable grounds, Texas courts will frequently apply the legal rules contained in the Civil Practice and Remedies Code to the appointment of the receiver.

13.7.3 **Receiverships Are Available In Trust Litigation**: A court has inherent equitable power to appoint a receiver in trust litigation. *Caroll v. Caroll,* 464 S.W.2d 440 (Tex. Civ. App. - Amarillo, 1971); *Pfeiffer v. Pfeiffer*, 394 S.W.2d 679 (Tex. Civ. App. - Houston, 1965); *General Association of Davidian Seventh Day Adventists, Inc. v. General Association of Davidian Seventh Day Adventists,* 410 S.W.2d 256 (Tex. Civ. App. - Waco, 1966, writ ref'd n.r.e.)

13.7.4 **Legal Grounds: Texas Civil Practice & Remedies Code Chapter 64:**

13.7.4.1 **Texas Civil Practice & Remedies Code §64.001** provides that:

> A court of competent jurisdiction may appoint a receiver ... in any ... case where a receiver may be appointed under the rules of equity.

13.7.4.2 **Texas Civil Practice & Remedies Code §64.004** provides that:

> Unless inconsistent with this chapter or other general law, the rules of equity govern all matters relating to the appointment, powers, duties, and liabilities of a receiver and to the powers of a court regarding a receiver.

13.7.4.3 **Texas Civil Practice & Remedies Code §64.021** provides that:

> (a) To be appointed as a receiver for property that is located entirely or partly in this state, a person must:
>
> > (1) be a citizen and qualified voter of this state at the time of appointment;
> >
> > (2) not be a party, attorney, or other person interested in the action for appointment of receiver;
>
> (b) The appointment of a receiver who is disqualified under section (a) (1) is void as to property in this state.
>
> (c) A receiver must maintain actual residence in this state during the receivership.

Note that a corporation may not be a receiver. While these provisions may not apply to purely equitable receiverships, most courts will apply these rules to equitable receiverships.

13.7.4.4 **Texas Civil Practice & Remedies Code §64.023** provides that:

> Before a person assumes the duties of a receiver, he must execute a good and sufficient bond that is:
>
> > (1) approved by the appointing court;
> >
> > (2) in an amount fixed by the court; and
> >
> > (3) conditioned on faithful discharge of his duties as receiver in the named action and obedience to the orders of the court.

13.7.4.5 **Texas Civil Practice & Remedies Code §64.031** provides that:

> Subject to control of the court, a receiver may:
>
> > (1) take charge and keep possession of the property;
> >
> > (2) receive rents;
> >
> > (3) collect and compromise demands;
> >
> > (4) make transfers;

> (5) perform other acts in regard to the property as authorized by the court.

13.7.4.6 **Texas Civil Practice & Remedies Code §64.032** provides that:

> As soon as possible after appointment, a receiver shall return to the appointing court an inventory of all property received.

13.7.4.7 **Texas Civil Practice & Remedies Code §64.033** provides that:

> A receiver may bring suits in his official capacity without permission of the court.

13.7.4.8 **Texas Civil Practice & Remedies Code §64.034** provides that:

> ... a receiver may invest for interest any funds that he holds.

13.7.4.9 **Texas Civil Practice & Remedies Code §64.052** provides that:

> (a) A receiver who holds property in this state may be sued in his official capacity in a court of competent jurisdiction without permission of the court;
>
> (b) A suit against a receiver may be brought where the person whose property is in receivership resides.
>
> (c) In a suit against a receiver, citation may be served on the receiver or on any agent of the receiver who resides in the county in which the suit is brought.
>
> (d) The discharge of a receiver does not abate a suit against the receiver or affect the right of a party to sue the receiver.

13.8 **BOND INCREASE:**

13.8.1 **Tex. Trust Code §113.058** provides that:

> (a) A corporate trustee is not required to provide bond to secure performance of its duties as trustee.
>
> (b) Unless the instrument creating the trust provides otherwise, a noncorporate trustee must give bond:
>
> (1) payable to each person interested in the trust, as their interests may appear; and
>
> (2) conditioned on the faithful performance of the trustee's duties.
>
> (c) The bond must be in an amount and with the sureties required by order of a court in a proceeding brought for this determination.
>
> (d) Any interested person may bring an action to increase or decrease the amount of a bond or to substitute or add sureties.

> (e) The trustee shall deposit the bond with the clerk of the court that issued the order requiring the bond. A suit on the bond may be maintained on a certified copy. Appropriate proof of a recovery on a bond reduces the liability of the sureties pro tanto.
>
> (f) Failure to comply with this section does not make void or voidable or otherwise affect an act or transaction of a trustee with any third person.

13.8.2 **Circumstances Under Which A Bond May Be Increased**: Tex. Trust Code §113.058 (d) does not address whether or not a beneficiary may bring an action to bond a trustee who, by the terms of the instrument creating the trust, is not required to give any bond. If there is a need to do so to protect the trust estate, an action may be probably maintained to increase a bond even if the trust instrument specifically provides that a bond is not required of the trustee.

13.9 **BREACHES INVOLVING DISCRETION**: A trustee may be sued for failing to properly exercise discretion in the administration of the trust.

13.9.1 **Abuse Of Discretion:** Courts will not substitute their own judgment for the judgment of trustees given discretionary powers. The exercise of discretion is, nevertheless, subject to the limitation that they must not act outside the bounds of reasonable judgment. *Thorman v. Carr,* 412 S.W.2d 45 (Tex. 1967). A trustee can not act arbitrarily however pure may be his motives. His discretion must be reasonably exercised to accomplish the purposes of the trust according to the settlor's intention and his exercise thereof is subject to judicial review and control. *State v. Rubion*, 308 S.W.2d 158 (Tex. 1957). See also *First National Bank of Beaumont v. Howard,* 229 S.W.2d 781 (Tex. 1950).

> Because of the fact that courts are reluctant to substitute their discretion for that of a trustee, abuse of discretion cases are difficult to win. A beneficiary has the burden of proving that the trustee exercised discretion but did so in such an unreasonable manner as to warrant judicial intervention.

13.9.2 **Failure To Exercise Discretion**: Failure to exercise discretion is a different action from abuse of discretion. Failure to exercise discretion is based on the fact that a trustee who was granted discretion has not exercised his discretion. This is a much less difficult case to win than an abuse of discretion case.

14 **DEFENSES/LIMITATIONS ON LIABILITY:**

Note that many of the defenses set forth below are affirmative defenses. TRCP Rule 94 provides that:

> In pleading to a preceding, a party shall set forth affirmatively accord and satisfaction, arbitration and award, assumption of risk, contributory negligence, discharge in bankruptcy, duress, estoppel, failure of consideration, fraud, illegality, injury by fellow servant, laches, license, payment, release, res judicata, statute of frauds, statute of limitations, waiver and any other matter constituting an avoidance or affirmative defense. ...

14.1.1 **Exculpatory Clauses:**

14.1.1.1 **Texas Trust Code § 113.059 provides**:

> (a) Except as provided in Subsection (b) of this section, the settlor by provision in an instrument creating, modifying, amending or revoking a trust may relieve the trustee from a duty, liability or restriction imposed by this subtitle.

> (b) A settlor may not relieve a corporate trustee from the duties, restrictions, or liabilities of section 113.052 or 113.053 of this Act.

14.1.1.2 **Exculpatory clauses will be strictly construed**. *Jewett v. Capital National Bank of Austin*, 618 S.W.2d 109 (Tex. Civ. App.--Waco 1981, writ ref'd n.r.e.). Texas courts will, however, recognize the validity of trust exculpatory clauses--this recognition is based on the above quoted provisions of the Texas Trust Code. *Gerdes, supra.*

14.1.1.3 **Exculpatory Clauses Deal With Financial Liability**: Exculpatory clauses generally relate to the extent of a trustee's liability for monetary damages for breach of trust. They do not typically relate to whether a trustee has, in fact, breached a fiduciary duty, or whether a trustee should be removed.

14.1.1.4 **Exculpatory Clauses Do Not Generally Modify Fiduciary Duties:** Most commentators recognize the distinction between modifying a fiduciary duty and exculpating a trustee for damages for breach of a fiduciary duty. Exculpatory clauses do not generally modify fiduciary duties. Some Texas Courts have failed or refused to recognize this distinction. In *Jochec v. Clayburne*, 862 S.W.2d 516 (Tex. Civ. App.-Austin 1993, writ denied) provisions of an exculpatory clause were deemed to modify a fiduciary duty. It is the opinion of the author that this case is clearly wrong on this point.

14.1.1.5 **Exculpation Clauses and Self Dealing:** The common law of Texas Courts has long held that a trustee may not, as a matter of public policy, be exculpated for self dealing. For example, the Supreme Court in *Wichita Royalty Co. v. City Nat. Bank of Wichita Falls*, 89 S.W.2d 394 (Tex. 1935) held that:

> The trustee's powers are broad, but ... no stipulation of the declaration is susceptible to the construction that the trustee is privileged to use the trust property or credit for his own benefit. While he is to be held responsible, "only for his own willful and corrupt breach of trust and not for any honest error of judgment" he has no interest in the trust or its property other than a managing interest, and such interest as may be evidenced by a certificate of ownership.

See also: *Langford v. Shamburger,* 417 S.W.2d 438 (Tex. App.--Ft. Worth, 1967); *InterFirst Bank Dallas, N.A. v. Risser,* 739 S.W.2d 882 (Tex. App.--Texarkana, 1987, reh'g Denied).

The court in *Shamburger* held that a settlor could not exculpate a trustee for self dealing. This ruling, which was the law in Texas for approximately three decades has recently been reversed by the Texas Supreme Court.

In the case of *Texas Commerce Bank, N.A. v. Grizzle*, supra the Texas Supreme Court held that:

> While the Trust Code imposes certain obligations on a trustee--including all duties imposed by the common law --the Trust Code also permits the settlor to modify those obligations in the trust instrument. Indeed, Trust Code section 113.059 broadly states that a settlor may relieve a corporate trustee from a "duty, liability, or restriction imposed by this subtitle," except for those contained in sections 113.052 and 113.053. The Trust Code contains no other limitations on relieving a corporate trustee from liability for self-dealing in a trust instrument. Thus, we conclude that the Trust Code allows an exculpatory clause to relieve a corporate trustee from

liability for self-dealing defined as misapplying or mishandling trust funds, including failing to promptly reinvest trust monies, unless those activities violate the prohibitions in sections 113.052 and 113.053.

We disagree with the court of appeals' conclusion that public policy precludes such a limitation on liability. The court of appeals based its holding on other courts of appeals' decisions beginning with *Langford v. Shamburger. Langford* held that "[i]t would be contrary to the public policy of this State to permit the language of a trust instrument to authorize self- dealing by a trustee."

But as we have previously acknowledged, the State's public policy is reflected in its statutes. And the Legislature has spoken on self-dealing and exculpatory clauses in the Trust Code. The Legislature has expressly authorized the use of exculpatory clauses, stating that they can relieve a corporate trustee from liability except for certain narrow types of self-dealing not at issue here. We therefore decline to hold that a trust instrument cannot exonerate a trustee from liability for failing to promptly reinvest trust monies based on public policy. As we stated in *Lawrence v. CDB Services, Inc.*:

> Public policy, some courts have said, is a term of vague and uncertain meaning, which it pertains to the law-making power to define, and courts are apt to encroach upon the domain of that branch of the government if they characterize a transaction as invalid because it is contrary to public policy, unless the transaction contravenes some positive statute or some well- established rule of law.

We recognize that the Trust Code authorizes a settlor to exonerate a corporate trustee from almost all liability for self-dealing, and that this broad authority can lead to harsh results. But we presume the Legislature was aware of this when it enacted the Texas Trust Act in 1943 [FN47]--the predecessor to the Texas Trust Code--and when it subsequently enacted the Trust Code effective January 1, 1984. When the Texas Trust Act came into being, the Restatement of Trusts § 222 had been written; and when the Legislature enacted the Trust Code, the Restatement (Second) of Trusts § 222 [FN49] had been written. Both Restatements state, in part: **"[**a] provision in the trust instrument is not effective to relieve the trustee ...of liability for any profit which the trustee has derived from a breach of trust.**"**

14.1.1.6The Texas Legislature in response to *Grizzle* amended Texas Trust Code §113.059 to incorporate the provisions to Restatement of the Law 2d, Trusts §222. This section now reads:

(a) Except as provided by this section, the settlor by provision in an instrument creating, modifying, amending, or revoking the trust may relieve the trustee from a duty, liability, or restriction imposed by this subtitle.

(b) A settlor may not relieve a corporate trustee from the duties, restrictions, or liabilities of Section 113.052 or 113.053 of this Act.

(c) A settlor may not relieve the trustee of liability for:

(1) a breach of trust committed:

(a) in bad faith;

(b) intentionally; or
(c) with reckless indifference to the interest of the beneficiary; or
(2) any profit derived by the trustee from a breach of trust.

(d) A provision in a trust instrument relieving the trustee of liability for a breach of trust is ineffective to the extent that the provision is inserted in the trust instrument as a result of an abuse by the trustee of a fiduciary duty to or confidential relationship with the settlor.

14.1.1.7 ***The Restatement of Trusts 2d*** has long recognized restrictions on trust exculpation. *Restatement of the Law of Trusts 2d* § 222 (2) provides that:

> A provision in the trust instrument is not effective to relieve the trustee of liability for breach of trust committed in bad faith or intentionally or with reckless indifference to the interest of the beneficiary, or of liability for any profit which the trustee has derived from the breach of trust.

14.1.1.8 **Austin W. Scott and William F. Fratcher, *The Law of Trusts* (Fourth Edition) § 222** provides that:

> **§222 Exculpatory Provisions**:
> A trust instrument not infrequently contains a provision relieving the trustee from liability for certain kinds of breaches of trust. Thus it is sometimes provided that the trustee shall not be liable "except for his willful default or gross negligence." Such provisions may fail to relieve the trustee from liability for breach of trust, either (1) because the breach of trust does not fall within the scope of the exculpatory provision; (2) because the breach of trust is such that it is against public policy to relieve the trustee from liability; or (3) because the provision was improperly inserted in the trust instrument.
>
> In a number of cases the trustee has been relieved of liability because of such a provision where otherwise he would have been subject to a surcharge for a loss resulting from his failure to use proper care in the administration of the trust. In these cases it is held that the provision is not effective on the ground that it is against public policy, if it merely relieves the trustee of liability for ordinary negligence. In New York, however, as we shall see, it is provided by a statute enacted in 1936 that an attempted grant to an executor or testamentary trustee of immunity from liability for failure to exercise reasonable care, diligence, and prudence shall be deemed contrary to public policy.
>
> **§222.1. Distinction between exculpatory provisions and those enlarging the trustee's powers.** A distinction is to be drawn between provisions in the trust instrument that permits the trustee to do acts that would not otherwise be permissible and a provision that merely relieves the trustee from liability if he does them. Thus by the terms of the trust the trustee may be authorized to invest in securities other than those in which a prudent man would invest. In such a case the powers of the trustee are enlarged by the provision. On the other hand, the

> trustee may not be authorized to make such investments but it may be provided by the terms of the trust that he shall not be liable for making investments unless he is guilty of an intentional breach of trust or of gross negligence. The effect of a provision enlarging the power of the trustee is to prevent acts from constituting a breach of trust that would otherwise be in breach of trust. The effect of a provision relieving the trustee of liability for breach of trust, however, is not to extend his powers but to restrict his liabilities. Such a provision does not prevent an act by the trustee from being a breach of trust if the act is not within his powers; but it does relieve him to a certain extent from liability for the consequences of his act. The distinction has been recognized in cases in which it has been held that although a trustee who commits a breach of trust may be relieved from liability, yet he cannot recover compensation with respect to the transaction that is in breach of trust. Thus in *Warren v. Pazoli*a trustee expended the greater part of the trust estate in the erection of an office building. It was held that he thereby committed a breach of trust, and that he was not entitled to compensation with respect to this transaction; but it was also held that he was not liable for the loss to the estate resulting from his act, since it was provided in the trust instrument that he should be liable only for "wilful neglect or default." So also in *Matter of Mallon* it was held that where it was provided by the terms of the trust that a trustee should be liable only for "his own willful default," and he negligently permitted his co-trustee to misappropriate trust funds, he was not entitled to commissions, but he was not liable for the breach of trust.
>
> **§222.2 Exculpatory provision strictly construed.** Where by the trust instrument it is provided that the trustee shall be relieved from liability for certain kinds of breaches of trust, or shall be liable only for certain kinds of breaches of trust, or shall be liable only for certain kinds of breaches of trust, the trustee is liable in spite of the provision if he commits a breach of trust that does not fall within the scope of the exculpatory provision ...

14.1.1.9 **George Gleason Bogert and George Taylor Bogert, *The Law of Trusts and Trustees* (Second Edition Revised) at §542** takes a somewhat different view. This section is quoted below.

14.1.1.10 **Public Policy Limitations on Exculpation**: *Restatement of Trusts, supra* at §222 (2) provides that:

> A provision in the trust instrument is not effective to relieve the trustee of liability for breach of trust committed in bad faith or intentionally or with reckless indifference to the interest of the beneficiary, or of liability for any profit which the trustee has derived from a breach of trust.
>
> *Scott, supra* at § 222.3 provides that:
>
> Even though the trustee commits a breach of trust that is of a kind for which by the terms of the trust he is relieved from liability, the provision is ineffective to protect him if it is

against public policy to give him such protection. No matter how broad the provision may be, the trustee is liable if he commits a breach of trust in bad faith or intentionally or with reckless indifference to the interests of the beneficiaries, or if he has personally profited through the breach of trust.

It is arguable that a provision in the trust instrument relieving the trustee from liability even for ordinary negligence is against public policy. There has been of late years a growing feeling that it is improper for a professional trustee as least, who professes to give careful and skillful service, to escape liability for failure to afford such service. In other words, there is a growing feeling that certain duties and certain standards of conduct are applicable to the relationship between trustee and beneficiaries, and that these are so necessarily inherent in the relation that they cannot be dispensed with by any provision in the trust instrument. In the absence of a statute, however, such provisions are not regarded as against public policy if they merely relieve the trustee from liability for ordinary negligence...

Bogert, supra at §542 provides that:

There are, however, limitations on the effectiveness of these immunity clauses. It would doubtless be regarded as against public policy to excuse a trustee from liability for the consequences of willful negligence or default, or bad faith or gross negligence. Such immunities have a tendency to encourage embezzlement and undesirable slackness. A settlor who creates a trust will not be permitted to attach provisions which in reality negate any gift and which allow the trustee to use the property for himself or for the beneficiary as he likes. A trust implies an equitable duty to apply for the benefit of the beneficiary. An immunity clause covering all possible breaches of trust connotes no enforceable duty at all toward the beneficiary, or else no remedy for breaches of duty which are unconscionable....A clause permitting a trustee who has violated his trust to retain a profit made from breach would also doubtless be void as against public policy.

The courts have recognized a number of exceptions to the validity of exculpatory clauses, sometimes on the ground that the particular clause violates public policy. Clearly the trustee will be liable for fraudulent conduct such as embezzlement or other misuse of trust funds. It is generally held that an exculpatory clause will not excuse the trustee from liability for acts performed in "bad faith" or with "gross negligence," the latter phrase often being construed as "reckless indifference to the interests of the beneficiary." If the breach of trust results in personal profit to the trustee or constitutes disloyalty to the beneficiary, the trustee will be held liable. Morever, an exculpatory clause may be held invalid or inappropriate if had been inserted in the instrument as the result of an abuse by the trustee of his fiduciary or confidential relationship with the settlor.

Further, exculpatory clauses have been construed not to exempt the trustee from liability for loss arising from one or more acts exceeding his powers or for failure to secure possession of or to protect the trust estate. Nor will such a clause protect the trustee from liability for making improper payments from the trust. An exculpatory clause excusing a trustee from liability for the acts of his agents or employees in generally supported by its given strict construction. Such a clause does not apply to liability of a corporate trustee for breach of trust committed by the corporate trustee through its officers who act on its behalf.

Professional Trustees

The insistence of some *professional trustees* that immunity clauses be inserted into their trust instruments, clauses which relieve the trustee from all liability except for willful default, after having made representations in the negotiations leading to the creation of the trust that the trustee possessed special care and skill, seems a questionable practice. Thus if a corporate trustee's new business department claims the highest of qualifications for fiduciary service, it would seem to impliedly represent that the settlor and beneficiaries will get the full benefit of such extraordinary abilities after the trust instrument is executed and trust administration starts, and that if this standard is not met the institution will be liable. However the trust instrument guarantees to the settlor and beneficiaries nothing more than an abstention from intentional wrongdoing by the trustee. Under such an instrument, if the trustee gives unusually high service it does so voluntarily and not because any court will hold it to that standard. It is believed that the insistence on the validity of such a clause tends to create bad public relations toward corporate trustees.

If the trust instrument provides that the *beneficiaries* shall hold the trustee harmless from liability, the clause may reasonably be construed to merely provide against liability incurred to third persons in the proper execution of the trust and not to liability for breach of the trust.

The exculpatory clause is said to be used frequently in trusts where a bank or trust company acts as trustee for bondholders under a mortgage and where it is claimed that the small compensation involved justifies the lowering of the standards as to the trustee's performance.

Because of the higher standard of care now generally imposed upon professional trustees, an exculpatory clause in a trust instrument under which a professional trustee is acting is often given strict construction by the court in determining whether the professional trustee should be relieved of liability, particularly where the trustee had procured inclusion of the clause or had occupied a fiduciary relationship towards the settlor at the time of creation of the trust.

Effects of Other Clauses

A result similar to that obtained under a valid exculpatory clause is sometimes obtained by a provision in the trust

> instrument or by a statute, for example, one which relieves the trustee of liability where responsibility for investments or another fiduciary duty is assigned to a third party, an advisor or to one or more of several trustees. Thus under several recent statutes, the excluded trustee has not duty to inquire into or participate in the performance of such duty in the absence of "actual knowledge" that the other are contemplating committing or concealing a breach of trust.
>
> In itself an exculpatory clause does not serve to reduce or enlarge the standard of care required of the trustee in the administration of the trust, since the effect of the clause is merely to relieve the trustee of personal liability for loss resulting from failure to meet the required standard. Other remedies for such failure may remain unavailable.
>
> The grant of absolute or uncontrolled discretion to the trustee in the administration of the trust, without an exculpatory clause, may not relieve the trustee of liability for imprudent exercises of his powers, but such a clause is sometimes construed to exonerate the trustee from liability under the circumstances.
>
> Although an exculpatory clause may relieve the trustee liability for damages, there may be other remedies available to the beneficiary, for example, removal of the trustee, enjoining the trustee from committing an improper act, or denial or reduction of the trustee's compensation.
>
> Exculpatory clauses should be distinguished from clauses in the trust instrument which merely relieve the trustee of a particular duty or which give the trustee absolute or uncontrolled discretion in the administration of the trust.

14.1.1.11 **Texas has Adopted The Restatement Limitations On Exculpation:** The *Risser* Court specifically adopted the restrictions contained in the *Restatement of Trusts 2d* by holding that:

> Provisions in an instrument creating the trust can relieve the trustee of certain duties, restrictions, and liabilities imposed on him by statute.... However, the language cannot authorize self-dealing by a trustee, because that would be contrary to public policy..... This limitation should include any situation in which a trustee used the position of trust to obtain an advantage by action inconsistent with the trustee's duties and detrimental to the trusts. Neither can an exculpatory provision in the trust instrument be effective to relieve the trustee from liability for action taken in bad faith, or for acting intentionally adverse or with reckless indifference to the interests of the beneficiary.

14.1.1.12 The Dallas Court of Appeals has also adopted these restrictions. In *Grider v. Boston Co. Inc.*, 773 S.W.2d 338 (Tex. App.--Dallas 1989) the Court held that:

> When the parties bargain on equal terms, a fiduciary may contract for the limitation of his liability. *Cf. Risser*, 739 S.W.2d at 888. However, public policy precludes the limitation of liability for (1) self-dealing, (2) bad faith, (3) intentional

> adverse acts, and (4) reckless indifference with respect to the beneficiary and his best interest.....

14.1.2 **In Terrorem Clauses:**

14.1.2.1 **General:** *In Terrorem Clauses* are clauses in trust instruments that provide that a beneficiary's interest in the trust will be forfeited it the beneficiary asserts certain legal action against the trust or the trustee.

> Once a beneficiary files an action that violates the *in terrorem* clause, then he is theoretically automatically removed as a beneficiary of the trust and arguably lacks standing to pursue his cause of action.

14.1.2.2 **Validity:** *In Terrorem* clauses are generally valid in Texas. See *Hammer v. Powers,* 819 S.W.2d 669 (Tex.Civ.App.--Ft. Worth 1991, no writ); *Calvary v. Calvary,* 122 Tex. 204, 55 S.W.2d 527 (Tex. Comm. App.1932, opinion adopted) *Massie v. Massie*, 118 S.W. 219 (Tex.Civ.App. 1909). An *in terrorem* clause that would be triggered by a beneficiary's contesting the validity of the trust is unquestionably valid in Texas. While there is little law on the point, an *in terrorem* clause that would be triggered by a beneficiary's suing a trustee for breach of trust is probably not valid on public policy grounds. The beneficiary is the person charged in equity with enforcing the trust. If the beneficiary was prevented by an *in terrorem* clause from enforcing the trust then an integral element of the trust would be destroyed. This should be against public policy.

14.1.2.3 ***In Terrorem* clauses will, however, be strictly construed**. See *Estate of Newbill,* 781 S.W.2d 727 (Tex.Civ.App.--Amarillo 1989, no writ); *Gunter v. Poague,* 672 S.W.2d 840 (Tex. Civ. App.-Corpus Christi 1984, writ ref'd n.r.e.); *Sheffield v. Scott,* 662 S.W.2d 674 (Tex.Civ.App.--Houston [14th Dist.] 1983, writ ref'd n.r.e.)

14.1.2.4 **Public Policy Considerations:** There are public policy restrictions on the applicability of In Terrorem clauses. Even if a will or trust contains an *In Terrorem* clause, if the contest or other litigation is brought "in good faith and with probable cause for recovery" Texas courts will probably not enforce the *In Terrorem* Clause. See *Hammer,* supra, and *Calvary,* supra.

14.1.3 **Release:**

14.1.3.1 **Texas Law:**

Tex. Trust Code §114.005 provides that:

> (a) A beneficiary who has full legal capacity and is acting on full information may relieve a trustee from any duty, responsibility, restriction, or liability as to the beneficiary that would otherwise be imposed on the trustee by this subtitle, including liability for past violations, except as to the duties, restrictions, and liabilities imposed on corporate trustees by Section 113.052 or 113.053 of this subtitle.
>
> (b) The release must be in writing and delivered to the trustee.

Tex. Trust Code §114.032 provides that;

> (a) A written agreement between a trustee and a beneficiary, including a release, consent, or other agreement relating to a trustee's duty, power, responsibility, restriction, or liability is final

and binding on the beneficiary and any person represented by a beneficiary as provided by this section if:

(1) the instrument is singed by the beneficiary;

(2) the beneficiary has legal capacity to sign the instrument; and

(3) the beneficiary has full knowledge of the circumstances surrounding the agreement.

(b) A written agreement by a beneficiary who has the power to revoke the trust or the power to appoint, including the power to appoint through a power of amendment, the income or principal of the trust to or for the benefit of the beneficiary , the beneficiary's creditors, the beneficiary's estate, or the creditor of the beneficiary's estate is final and binding on any person who takes under the power of appointment or who takes in default if the power of appointment is not executed.

(c) A written instrument is final and binding on a beneficiary who is a minor if:

(1) the minor's parent, including a parent who is also a trust beneficiary, signs the instrument on behalf of the minor;

(2) no conflict of interest exists; and

(3) no guardian, including a guardian ad litem, has been appointed to act on behalf of the minor.

(d) A written instrument is final and binding on an unborn or unascertained beneficiary if a beneficiary who has an interest substantially identical to the interest of the unborn or unascertained beneficiary signs the instrument. For purposes o this subsection, an unborn or unascertained beneficiary has a substantially identical interest only with a trust beneficiary from whom the unborn or unascertained beneficiary descends.

(e) This section does not apply to a written instrument that modifies or terminates a trust in whole or in part unless the instrument is otherwise permitted by law.

14.1.3.2 **Other Authorities:**

Restatement of Trust, Second, supra, at §217 provides that:

Discharge of Liability by Release or Contract

(1) A beneficiary may preclude himself from holding the trustee liable for a breach of trust by a release or contract effective to discharge the trustee's liability to him for that breach.

(2) A release or contract is not effective to discharge the trustee's liability for a breach of trust, if:

(a) the beneficiary was under an incapacity at the time of making such release or contract; or

(b) the beneficiary did not know of his rights and of the material facts which the trustee knew or should have known and which the trustee did not reasonable believe that the beneficiary knew; or

(c) the release or contract of the beneficiary was induced by improper conduct of the trustee; or

(d) the transaction involved a bargain with the trustee which was not fair and reasonable.

Scott, supra, at §217 provides that:

§217. Discharge of Liability by Release or Contract

If the trustee commits a breach of trust without the consent of the beneficiary previously given, he may nevertheless be relieved of liability if the beneficiary subsequently discharges him by contract or accord and satisfaction or by a release. The principle here applicable is the same as that governing discharge of liability upon a contract, except that since the relation is a fiduciary relation there are the same limitations as are applicable to the consent of the beneficiary to a breach of trust discussed in the preceding section. The discharge is effective only if the beneficiary had knowledge of all relevant facts that the trustee knew or should have known and of his legal rights and the discharge was not induced by improper conduct on the part of the trustee. Of course the discharge is ineffective if the beneficiary was an infant or otherwise not sui juris. The effect of a release by the beneficiary of his interest in the trust property is considered hereafter.

Bogert: *Bogert, supra* at §943 provides that:

§ 943. Release

Where a cause of action has been established by a judgement or decree against the trustee for breach of trust, or against a third person for participating in a breach, or where the beneficiary believes that he has such a cause of action although no court has considered the matter, the beneficiary may release the trustee or the third party from liability and thereby extinguish such cause of action as may exist, if the conditions precedent to the validity of such release exist, as described later herein.

Release should be distinguished from *surrender*, which is action by the beneficiary which extinguishes the trust and leaves the trustee the owner of the property freed from trust obligations, and also from a "sale" by the beneficiary to the trustee of the interest of the former under the trust which results in a change in the equitable ownership of part or all of the trust property.

Not only do the rules applicable to all releases with respect to form, consideration, and other matter apply here, but in the case of release of fiduciary special requirements are set by the courts. As shown in an earlier section any direct dealing between a fiduciary and the person whom he represents is viewed with suspicion. In order that the transaction may be upheld the fiduciary must bear the burden of proving the fairness of the arrangement. In the case of releases, as in other instances of dealing between fiduciary and the person for whom he is acting, there must be proof of full disclosure by the trustee of the facts of the situation and the legal rights of the beneficiary, and there must be adequate consideration paid. In addition the trustee must negative fraud by positive misrepresentation or concealment, or duress or undue influence, or by other unfairness.

Sometimes a release of the trustee from liability for breach is obtained by the making of a contract by the trustee to furnish the beneficiary with substituted benefits, or by the making of some other financial arrangement, or by the delivery of property which is alleged to constitute the res to which the beneficiary is then entitled. The efficacy of such a release will be judged by the adequacy of the consideration, the extent of disclosure given by the trustee to the beneficiary, the competence of the beneficiary, and any other features which affect the fairness of the transaction.

Under the common law the release of one joint tortfeasor releases al, on the theory that there is a single cause of action, and hence some courts administering equity have felt bound to apply the same doctrine to the release of one co-trustee where two or more trustees have committed a breach of trust. But this result is not decreed where the transaction was a covenant not to sue instead of a release. There has been some statutory tendency to abolish the technical rule regarding the effect of a release.

If the release is to be valid, it must be explicit and not vague. Apart from a statute there would seem to be not formal requirements as to the method of release. For example, the use of the will of beneficiary has been sanctioned. If the trust is spendthrift, a release which is an indirect method of alienating the beneficiary's interest will be held invalid. Where several beneficiaries have causes of action against the trustee, each may release for himself but not for the others. The release should bind successors in interest of the beneficiary who gave it. If a successor trustee receives as part of the trust property a cause of action against the predecessor for breach of trust, he should have power to release it, but not otherwise.

An attempted release my be voidable or void on account of the infancy or lack of mental capacity of the beneficiary in question.

Whether a release is general and covers all breaches of trust, or is particular and intended to release the trustee from liability for one or more specific breaches, is a question of construction.

It would not seem that a release could be withdrawn or rescinded, unless it was obtained by wrongful conduct of the trustee, or was given to take effect on the happening of a condition which did not transpire. The jurisdiction of any particular court to determine the validity of a release is a matter of local statute or constitution.

14.1.4 **Consent:**

14.1.4.1 **Texas Law:**

See Tex. Trust Code §114.032, *supra*.

14.1.4.2 **Other Authorities:**

Restatement of Trusts, supra at §216 provides that:

§216 Consent of Beneficiary

(1) Except as stated in Subsections (2) and (3), a beneficiary cannot hold the trustee liable for an act or omission of the trustee as a breach of trust if the beneficiary prior to or at the time of the act or omission consented to it.

(2) The consent of the beneficiary does not preclude him from holding the trustee liable for a breach of trust, if :

(a) the beneficiary was under an incapacity at the time of such consent or such act or omission; or

(b) the beneficiary, when he gave his consent, did not know of his rights and of the material facts which the trustee knew or should have known and which the trustee did not reasonably believe that the beneficiary knew; or

(c) the consent of the beneficiary was induced by improper conduct of the trustee.

(3) Where the trustee has an adverse interest in the transaction, the consent of the beneficiary does not preclude him from holding the trustee liable for a breach of trust not only under the circumstances stated in Subsection (2), but also if the transaction to which the beneficiary consented involved a bargain which was not fair and reasonable.

Scott, supra at §216 provides that:

§216 Consent of Beneficiary

A beneficiary who consents to an act or omission by the trustee that would constitute a breach of trust cannot hold him liable for the consequences of the act or omission, if the beneficiary was sui juris and had full knowledge of all relevant facts and of his legal rights and if his consent was not induced by any improper conduct of the trustee. Thus a beneficiary cannot

complain of a loss resulting from an improper investment made by the trustee with his consent, or of a failure to sell trust property which the trustee was under a duty to sell if the beneficiary consented to its retention, or of a sale or mortgage or lease not authorized by the terms of the trust but consented to by the beneficiary. As an English judge once said: "It is a proposition revolting to one's common understanding that a person should desire his trustee to do a particular act, he being sui juris, and under no influence, and then afterwards file a bill against him for having done that which he desired him to do." Mr. Justice Holmes, when sitting on the Massachusetts bench, said that "There is no illegality in a cestui que trust authorizing an act which otherwise would be a breach of trust towards himself, or in his releasing or agreeing to hold harmless his trustee for such an act after it is done."

It is to borne in mind, however, that the effect of a beneficiary's consent is not to enlarge the powers of the trustee, but merely to preclude the beneficiary from holding the trustee liable for the consequences of the act or omission to which he has consented. As was said in a case in New York by Lehman, J., "Consent by a beneficiary in advance may bar claim for redress, on the theory of volenti non fit injuria, but consent cannot enlarge nor objection limit the powers of the trustee."

A distinction is to be drawn between consent of the beneficiary and mere failure to object. The mere fact that the beneficiary knows that the trustee is committing a breach of trust and fails to make any objection is not sufficient to preclude him from holding the trustee liable for the breach of trust. On the other hand, the beneficiary is precluded by his consent from holding the trustee liable for breach of trust even though he did not request the trustee to deviate from the terms of the trust. In other words, it is immaterial whether the suggestion that the trustee should deviate from the terms of the trust came from the beneficiary to show that his consent was improperly procured by the trustee where the suggestion came from the trustee than it is where the beneficiary himself originated the suggestion and requested the trustee to do what would otherwise render him liable for breach of trust.

The consenting beneficiary cannot complain even of acts that would constitute a violation of the duty of loyalty, as where the trustee purchases for himself the trust property or sells his individual property to himself as trustee, although in such cases the transaction will be set aside not only if the trustee fails to disclose all relevant facts but also where the transaction is not in all respects fair to the beneficiary.

If the beneficiary retracts his consent prior to the act or omission, he is of course not precluded from holding the trustee liable. Thus if he authorizes the trustee to invest in property that would not otherwise be a proper trust investment but before the trustee nevertheless makes the investment, the trustee is liable for doing so. So also if he consent to the making of an improper investment but subsequently directs the

trustee to sell the property in which he has invested, the trustee is liable for any loss resulting from his failure to sell it thereafter although he is not liable for the making of the investment. The consent by a beneficiary to the retention of securities in the trust that are not proper trust investments does not preclude a person who succeeds to the beneficiary's interest from insisting on the sale of the securities.

The principle here stated is applicable where the trustee make a payment to the beneficiary before the time when by the terms of the trust the payment should be make. Thus is the trustee makes payment of income to the life beneficiary before the income has accrued, the beneficiary cannot compel the trustee to pay him over again. Similarly if by the terms of the trust to the principal is not to be paid to the beneficiary until he reaches a certain age or until the happening of some other event and the trustee conveys the trust property to him before he reaches that age or the event happens, the beneficiary cannot subsequently hold him liable for so doing.

Bogert, supra at §941 provides that:
§941 Consent

If a beneficiary of full age and sound mind, acting with full knowledge of the facts of the case and of his rights, and not under the influence of misrepresentation, concealment, or other wrongful conduct on the part of the trustee or another, consents that the trustee or a third person perform an act or refrain from performing an act, equity will not permit the beneficiary to allege thereafter that the conduct of the trustee or third person to which consent was given was a breach of trust, or amounted to participation in a breach.

The rules for the administration of trusts, established by the trust instrument, statute, and by the court, are primarily for the benefit of the beneficiary. If he voluntarily withdraws from their protection, when fully competent, he ought to be permitted to do so. There is nothing against public policy in giving validation to his consent. He cannot come into equity and complain of an act which he has expressly sanctioned without violating the "clean hand" doctrine of chancery. The trustee or the third person, or both, have by hypothesis acted on the consent of the beneficiary. It would be unfair to allow him thereafter to contend that the act which he impliedly said would be rightful was in fact wrongful. He would be entrapping the opposing party.

The application of the consent doctrine in avoiding liability to a beneficiary, is common.

If the beneficiary does not merely consent that the trustee may perform an act but joins the trustee in the transaction, or causes the trustee to take part in it, he should of course be barred from making a later objection.

The beneficiary has no duty to advise or assist the trustee n the trust administration. Directions by him may be ignored. The

trustee has no power to require the beneficiary to consent or object to a proposed act. The beneficiary may take the position that the operation of the trust was placed in the hands of the trustee by the settlor and that the trustee must make the decisions involved. Mere passivity or silence by the beneficiary does not amount to consent to a proposal which the trustee has made, where there is no judicial proceeding such as an accounting or request for court approval of a proposed transaction.

Where a beneficiary is a party to a judicial proceeding in which the trustee request court authorization for an act, there is a duty on the part of the beneficiary to object if he disapproved the proposal, and silence may be deemed to show consent. And, as shown elsewhere, where the trustee's accounts are presented for judicial approval, silence by the beneficiary and later court approval will bar the beneficiary from later objection.

Thus a beneficiary who in advance approves an investment, or the retention or change of an investment, on which would otherwise be nonlegal, cannot thereafter complain of the trustee's action, and the rule may be applied to may other types of transactions, for example, approval of a sale of trust property under certain terms and conditions. Other examples include approval of the making of a mortgage of the trust realty, or a lease, or the delegation of powers, or the acceptance of a low rate of interest, or the making of a contract, or the continuance of a business, or a division of income, or the fixing of the compensation of the trustee.

Frequently a beneficiary consents to the allocation of expense and receipt items between trust principal and income in a certain manner, and is thereby prevented from raising a later objection. Another major field for the application of the doctrine is found in cases where the beneficiary approves of conduct of the trustee involving a conflict of interest and is thus barred from raising the objection of disloyalty.

Consent to an otherwise unlawful act under a trust should be distinguished from consent to an alteration of the trust. The latter is not within the powers of the beneficiary ordinarily.

It would seem that consent of the beneficiary can be withdrawn before it is acted upon, but not thereafter.

Where the consent is given to the trustee, it may fall under the doctrine previously outlined, to the effect that all direct dealings between trustee and beneficiary are regarded with suspicion by the court, that the trustee must bear the burden of proving that such dealings were conducted by him with the utmost fairness, and that full disclosure and independent advice are considered as important lights on the honesty of the transaction. A consent obtained by concealment, misrepresentation, mistake, duress or undue influence, will be voidable by the beneficiary, whether given to the trustee or third person.

Not only must the beneficiary be informed as to the facts surrounding the transaction to be approved, but he must also made cognizant of the legal effect of his consent, for example, that it will validate an investment which would otherwise be nonlegal, or it will settle an income and principal problem as to which there was doubt. This involves explaining to the beneficiary why his consent is being requested, where the trustee is taking the initiative.

If the beneficiary is laboring under and legal disability, for example, infancy or mental weakness, his consent will not be binding upon him.

The power of the representative of an infant or insane beneficiary, such as a guardian, to bind the incompetent, depends largely on local statutes and the terms of the appointment of the guardian or other fiduciary.

One beneficiary cannot consent for another to a breach of trust, nor can a majority of the beneficiaries, either in interest or in number, bind the minority by a request or consent that a breach of trust be performed. Where there are life and remainder beneficiaries, each can affect his own interest by consent, but not that of the other. In the absence of some doctrine of representation, it would seem clear that contingent or unborn beneficiaries cannot be bound by a consent of vested or living beneficiaries.

The consent of a beneficiary who has a transferable interest should prevent his subsequent assignee from alleging that the act was wrongful, but is should not affect beneficiaries who are successors under the terms of the trust instrument and do not acquire their interests from the party who consented.

Consents of beneficiaries of spendthrift trusts should be invalid if they directly or indirectly result in an alienation of the beneficiary's interest or make it liable to his debts. Otherwise consents in such trusts would seem subject to ordinary rules.

If a co-beneficiary has consented to a breach, a non-consenting beneficiary may have a right to reimbursement from the consenting beneficiary for any loss he suffers as a consequence of the consent. An agreement by a beneficiary to indemnify his trustee against liability for a breach of trust requested by the beneficiary has been upheld as not against public policy.

Consent of the beneficiary may be expressly made, by a term of the trust instrument, a condition precedent to the performance of an act by the trustee. After such consent the beneficiary cannot complain that the act was wrongful or that damage arose from the performance of it.

14.1.5 **Laches:**

14.1.5.1 **Texas Law:**

In *Culver v. Pickens,*176 S.W.2d 167 (Tex. 1943) the Texas Supreme Court defined laches as follows:

> Laches, in legal significance, is not mere delay but delay that works a disadvantage to another. So long as parties are in the same condition, it matters little whether one presses a right promptly or slowly, within the limits allowed by law; but when knowing his rights, he takes no steps to enforce them until the condition of the other party has, in good faith, become so changed that he cannot be restored to his former state, if the right be then enforced, delay becomes inequitable, and operates as estoppel against the assertion of the right.

See also, *Herschbach v. City of Corpus Christi,*883 S.W.2d 720 (Tex. App. - Corpus Christi, 1994)

14.1.5.2 **Other Authorities:**

Restatement of Trusts, Second, supra, at §219 provides that:

§219Laches of the Beneficiary

> (1) The beneficiary cannot hold the trustee liable for a breach of trust if he fails to sue the trustee for the breach of trust for so long a time and under such circumstances that it would be inequitable to permit him to hold the trustee liable.
>
> (2) The beneficiary is not barred merely by lapse of time from enforcing the trust, but if the trustee repudiates the trust to the knowledge of the beneficiary, the beneficiary may be barred by laches from enforcing the trust.

Scott, supra at §219 provides that:

§219 Laches of the Beneficiary

> A beneficiary may be barred by his laches from holding the trustee liable for a breach of trust. He is so barred if he fails to sue the trustee for the breach of trust for so long a time and under such circumstances that it would be inequitable to permit him to hold the trustee liable. Among the circumstances that are of importance are the length of time during which the beneficiary has delayed in bringing a proceeding against the trustee; the reasons for such delay; the character of the breach of trust; and the change of circumstances, if any, between the commission of the breach of trust and the bringing of the proceeding, such as the death of witnesses or parties, or a change of position by the trustee. Underlying the notion of the barring of suit because of laches is the general idea that it is in accordance with public policy that suits should be brought with reasonable promptness. There is also the idea that after the lapse of a long period of time it is difficult to ascertain the truth. There is also the idea of hardship to the defendant in pressing stale claims against him, although the hardship to him may be outweighed by the hardship to the plaintiff in denying him redress.

> In the case of actions at law these more or less delicate nuances are ignored. The legislature by the enactment of a statute of limitations lays down a definite rule providing that until a specified period of time has elapsed since the cause of action arose an action thereon is not barred, but the moment that the period has elapsed it is barred. In the case of such a statute it is immaterial whether hardship to the one party or the other in involved; it is even immaterial in most cases whether the plaintiff was ignorant of the fact that he had a right of action. The arbitrary operation of the statutes of limitations is very different from the operation of the equitable doctrine of laches, which is a very flexible doctrine. It is true that in some states there is a statute of limitations applicable to proceedings in equity, but such a statute is not applied with the same strictness with which the statues are applied to proceedings at law. Even under such a statue a proceeding in equity is not barred where the plaintiff had no notice of his cause of action, particularly where the defendant was in a fiduciary relation to the plaintiff.
>
> The cases involving the question whether the beneficiary is barred by his laches are very numerous. It is sufficient to cite a few representative cases. In some of the cases it is held that under all the circumstances the beneficiary should not be precluded from holding the trustee liable for breach of trust. On the other hand, it has not infrequently been held that the beneficiary was precluded by his laches from holding the trustee liable.

See also *Bogert, supra* §948 provides that:

> The long-continued failure of the beneficiary to assert a cause of action, when it is inexcusable, and when it is prejudicial to the person against whom the claim exists, may bar the beneficiary from obtaining judicial relief. This is the doctrine of "laches," the following statement of which has been made by the United States Supreme Court: "But there is a defense peculiar to courts of equity founded on lapse of time and the staleness of the claim, where no statute of limitation governs the case. In such cases, courts of equity act upon their own inherent doctrine of discouraging, for the peace of society, antiquated demands, refuse to intervene where there has been gross laches in prosecuting the claim, or long acquiescence int eh assertion of the rights."
>
> For example, delay and other attendant circumstances may prevent a beneficiary from claiming that a sale or mortgage of trust property by the trustee was wrongful or may bar a claim against the trustee for money damages.
>
> Though most of the cases involving laches are concerned with the enforcement of the remedies of the beneficiary, the doctrine is also occasionally applied to claims by the settlor or the trustee.
>
> The defense of laches is quite independent of the Statute of Limitations. The fact that a statutory period for barring of equitable causes of action has been set, or that equity by analogy follows the period set for barring legal causes of action, and declaring that the beneficiary had been guilty of laches and is

barred from recovery. Delay for a shorter period that the statutory limit, accompanied by other conditions, may be sufficient to destroy the beneficiary's remedy. "Independently of any statute of limitations, courts of equity uniformly decline to assist a person who has slept on his rights and shows no excuse for his laches in asserting them." if there is an applicable period and it has expired, consideration of laches will be futile in most cases because one reason for barring a cause of action in sufficient. Yet it would seem the court could hold that such a cause of action was barred on the ground of either the statute or laches.

Laches is a doctrine applicable alike to the rights of beneficiaries under resulting, constructive, as well as express trusts, although it has been said that he court is more reluctant to apply it to express trusts than to implied trusts.

The courts are less inclined to apply the doctrine of laches to a charitable trust, or against a government.

The rules with regard to the method of pleading laches depend upon local practice and upon whether the delay and change of circumstances are apparent on the face of the petition or not.
In defining and applying the doctrine of laches to trust cases the courts have laid great emphasis on the effect of the delay on the position of the person against whom the cause of action is sought to be enforced, and have required proof by the defendant, not merely that there has been long delay but that during this period of inactivity the position of the defendant has changed so that it will be3 much more difficult for him to present this case than it would have been if the alleged cause of action against him had been properly asserted.

"Laches, in legal significance, is not mere delay, but delay that works a disadvantage to another. So long as parties are in the same condition, it matters little whether one presses a right promptly or slowly, within the limits allowed by law; but when, knowing his rights, he takes no steps to enforce them until the condition of the other party has, in good faith, become so changed that he cannot be restored to his former state, if the right then be enforced, delay becomes inequitable rand operates as estoppel against the assertion of the right."

Other courts have laid stress on the inability of the courts to render justice where long delay has occurred, and have said that the basis of the doctrine of laches is the powerlessness of he courts to ascertain the truth after great lapse of time. ... The statement that the court will not act when it feels the delay has been such that the truth cannot be learned is essentially based on the idea of prejudice to the defendant.

Still other courts have placed emphasis on the thought that the doctrine of laches is founded on the public policy of encouraging neglect, or have given a presumption of abandonment or release as a reason for its application.

Bogert, supra §949 provides that:

Laches - Application

Though laches will not be adjudged because of the passage of any particular length of time, the longer the delay of the plaintiff the greater the likelihood that the court will hold him barred, as is shown in many cases involving considerable periods. On the other hand, if the time involved is relatively short, the courts are more apt to deny that there has been laches, but in occasional cases of slight delay coupled with great prejudice the doctrine has been applied.

Proof that Delay has been Prejudicial

If the trustee or other person against whom the equitable interests of the beneficiary are sought to be enforced pleads that the cause of action is barred because of laches, he has the burden of proving that a long delay has occurred since the date when the cause of action was alleged to have accrued, and also that, due to changes which have come about during the period of delay, the ability of the defendant to present evidence in defense has deteriorated. This proof of prejudice may be made in any one of several ways.

For example, the death of material witnesses or of the original trustee obviously will be a great handicap, as will the loss of important documentary evidence. The insanity of persons who would have been material witnesses will have the same effect. The court will take judicial notice that even though all parties and witnesses are living, their memories of distant events are likely to be uncertain.

Other facts which may tend to prove that the delay has been prejudicial are that the plaintiff has recognized the defendant as the beneficial owner of the property during the period of delay and thus caused him to be off guard and to fail to prepare for the defense of any trust claim, that the defendant has been bearing the burdens of ownership such as taxes and mortgage interest, or has been improving the property, and that the rights of third persons have become involved.

The courts are suspicious of claims founded on remote transactions where in the interval the property has greatly increased in value, and the plaintiff made no claim until this change had occurred. While such an event, if not caused by the labor and expenditures of the defendant, should not necessarily be a bar to the enforcement of an ancient claim, it does throw doubt on the sincerity of the plaintiff's case.

Excuses for delay

Where the party against whom the trust or other equitable interest is sought to be enforced pleads laches, and proves delay in bringing the suit and consequent great prejudice to himself, the burden is on the plaintiff to show a valid excuse for the delay. This he may do in several ways.

He ought not to be charged with laches if he had no knowledge of the breach or existence of the cause of action during the period of his delay, and could not by the exercise of reasonable care have obtained knowledge. Thus if the trustee by fraud, or concealment or

other wrongful conduct prevents the beneficiary from learning of a breach of trust, laches should not be applied.

A beneficiary cannot sit idly by and close his eyes to what is going on around him. "One who would repel the imputation of laches on the score of ignorance of his rights must be without fault in remaining so long in ignorance of those rights. Indolent ignorance and indifference will no more avail than will voluntary ignorance of one's rights." As a Pennsylvania court has said: "Laches is not excused by simply saying 'I did not know.' If by diligence a fact can be ascertained the want of knowledge so caused is no excuse for a stale claim. The test is not what the plaintiff knows, 'but what he might have known, by the use of the means of information within his reach, with the vigilance the law requires of him.'"

If the beneficiary and trustee were closely related, so that seeking trust enforcement out of court would be natural, a failure to suit may possibly be excused.

If the beneficiary was handicapped in bringing suit by reason of a physical or legal disability, such as sickness or infancy, the delay should not count against him.

Where the beneficiary, throughout the period of alleged laches, has continuously asserted his rights as a beneficiary, for example, by maintaining exclusive possession of the trust res, he will of course not be guilty of laches. And joint possession by beneficiary and trustee rebuts the idea of laches, since it shows a recognition of the interest of the beneficiary. Payment of taxes by the beneficiary shows an assertion of his right and militates against laches. That the land which is the subject of contention has been unoccupied during the period of laches is no excuse for inaction on the part of the beneficiary.

Evidence that the beneficiary was seeking to secure performance of the trust by negotiation with the trustee, or by self help, tends to rebut evidence of laches. However the fact that during the delay period he was seeking to enforce other remedies not connected with the trust has no effect as an excuse for the delay.

Strong evidence in contradiction of the allegation of laches is found in the continuous acknowledgment and performance of the trust by the trustee during the period of alleged laches. So long as the trustee acknowledges the trust and performs it, there is not breach of it. Nor does the laches period begin if the existence of the trust is so concealed from the beneficiary that he may reasonably remain ignorance of it. Laches can arise only from the conduct of the party to whom the cause of action runs, or his authorized representative.

Where a breach of trust gives rise to a cause of action in favor of income beneficiaries and a second cause of action for the benefit of remaindermen, it would seem that the delay of one group in asserting its rights should have no effect on the rights and remedies of the other group. However, remaindermen who have been injured cannot wait until the termination of the income trusts before making their claims without danger of being affected by laches.

14.1.6 **Waiver:**

14.1.6.1 **Texas Law:** Waiver is the intentional relinquishment of a known right or intentional conduct inconsistent with claiming that right. *Sun Exploration & Production Co. V. Benton,* 728 S.W.2d 35, 37 (Tex. 1987); *Edwin M. Jones Oil Co. v. Pend Oreille Oil & Gas Co.,* 794 S.W.2d 442, 447 (Tex. App. – Corpus Christi 1990, writ denied). It is a voluntary act and implies an election to dispense with something of value or to forego some advantage that might have been demanded or insisted upon. *Edwin M. Jones, supra* at 447; *El Paso Dev. Co. v. Berryman,* 769 S.W.2d 584, 589 (Tex. App. – Corpus Christi 1989, writ denied). Without an express renunciation of a known right, a waiver will not be presented or implied contrary to the intention of the party whose rights would be injuriously affected thereby, unless by his conduct the opposite party has been misled to his prejudice into an honest belief that the waiver was intended or asserted *to. Edwin M. Jones, supra* at 447; *El Paso Dev. Co., supra,* 589 - 90.

14.1.7 **Estoppel:**

14.1.7.1 **Texas Law:** Estoppel arises where by the fault of one, another has been induced to change his position for the worst. *Edwin M. Jones, supra* at 447. See *Wirtz v. Sovereign Camp W.OW.,* 268 S.W.2d 438, 441 (Tex. 1925); Pioneer Oil Co. v. Vallejo, 750 S.W.2d 928, 929 (Tex. App. – Corpus Christi, no writ) To constitute an equitable estoppel, there must exist: (1) a false representation or concealment of material facts; (2) made with actual or constructive knowledge of the facts; (3) to a party without knowledge, or the means of acquiring knowledge of the real facts; (4) made with the intention that it should be acted on; and (5) the party to whom it was made must have relied or acted on it to his prejudice. *to. Edwin M. Jones, supra* at 447; see also *Gulbenkian v. Penn,* 252 S.W.2d 929, 932 (Tex. 1952); *Swiderski v. Prudential Property & Casualty Ins. Co. ,* 672 S.W.2d 264, 269 (Tex. App. – Corpus Christi 1984, writ dism'd); *Frazier v. Wynn,* 472 S.W.2d 750 (Tex. 1971)

14.1.7.2 **Other Authorities:**

Bogert, supra, at 944: provides that:

> If a beneficiary has a cause of action for the enforcement of a trust, or for breach of a trust, and by his written or spoken words or other positive conduct, or by his silence when he has a duty to speak, asserts to another that no such cause of action exists, and the other party justifiably acts upon the misrepresentation in such a way that he cannot retreat without damage, the beneficiary may be estopped to assert his rights under the trust.
>
> The essential features of this type of estoppel have been explained at length in several treatises which deal with that subject. It is immaterial in what way the representation by the beneficiary is made, whether by speaking, writing, remaining silent or other conduct. He must make the representation to the party relying on the estoppel, or to some one acting for him. The representation must be voluntarily made, in the sense that the beneficiary knows that he is denying the existence of his equitable right. It need not be made with the intent of misleading the opposite party, but it must be a statement which the other party was justified in believing was made for the purpose of inducing action by him. There must be justifiable reliance by the other party. Hence, if he knows that the beneficiary's statement is false, he cannot use ita s basis of estoppel. The party to whom the representation is made must act upon the statement that the beneficiary has no interest as beneficiary or no cause of action under the trust. And this action

must be such as to cause damage to the third party if the beneficiary is now permitted to set up the trust or rights under it.

If the person who asserts estoppel as cutting off the rights of the beneficiary is a transferee by way of gift, or the taker of an equitable title only, there may be opportunity to apply the doctrine. However, if the trustee has conveyed the legal title to the trust property to an innocent purchaser, the transferee will be able to succeed in holding the property by reason of the use of the bona fide purchaser rule and will not need to allege estoppel.

The personal creditors of the trustee are, however, sometimes assisted by estoppel. They do not secure the protection of the bona fide purchaser rule. For example, if land is subject to a resulting trust and the beneficiary knows that the record title shows no trust and therefore makes the legal titleholder appear to be the absolute owner, the beneficiary knows or ought to know that the legal titleholder is incurring or reasonably may incur debts on the faith of his apparent ownership of the land. If the beneficiary does nothing to remove this deceptive condition, or fails to notify prospective creditors, a creditor who extends credit to the legal titleholder on the faith of such apparent ownership will be entitled to a lien on the land superior to the interest of the beneficiary. The rights of the beneficiary will be deemed cut off to the extent of the creditor's claim by the application of the doctrine of estoppel by misrepresentation. The beneficiary is deemed in such a situation to have represented to the community that the legal titleholder was the owner of the property.

A similar result occurs where there an oral unenforceable trust in land. The beneficiary will be estopped, in favor of creditors who have extended credit to the legal titleholder in reliance on his appearance of absolute ownership, to assert his equitable interest. "If a wife vests her property in her husband his permits him to appear to the world to be the owner thereof, and he contracts debts in the course of business while he is apparently such owner, she is estopped to deny, as against his creditors for such debts, that he was the owner."

Occasional examples are found in the reports of the application of the doctrine to beneficiaries, or persons similarly situated, or of the refusal to use it.

A beneficiary laboring under a disability ought no to be subject to having his rights cut off by estoppel.

14.1.8 **Quasi-estoppel:**

14.1.8.1 **Texas Law:** The principal of quasi-estoppel precludes a party from asserting, to another's disadvantage, a right inconsistent with a position he has previously taken. The doctrine applies when it would be unconscionable to allow a person to maintain a position inconsistent with one in which he accepted a benefit. Misrepresentation by one party, reliance by the other are not necessary elements of quasi-estoppel. *Lopez v. Munoz, Hockema & Reed, L.L.P.*, 22 S.W.3d 857 (Tex.2000)*; Vessels v. Anschutz,* 823 S.W.2d 762, 765 (Tex. App. - Texarkana 1992, writ denied); *Enochs v. Brown,* 872 S.W.2d 312, 317 (Tex. App. - Austin, 1994); *Atkinson Gas Co. v. Albrec,* 878 S.W.2d 236, 240 (Tex. App. Corpus Christi, 1994, writ denied)

14.1.9 **Statute of Limitations :**

14.1.9.1 **When the Statute Begins to Run**: In an action against a trustee for breach of fiduciary duty, statutes of limitations begin to run when a breach occurs and the beneficiary knows or with due diligence should have known of the trustee's breach. Many cases have analyzed whether a beneficiary had either notice of a breach or notice of facts sufficient to require a duty to investigate.

14.1.9.2 **Notice of breach:** In general, acts which constitute notice of a trustee's breach involve: a refusal of a beneficiary's demand for trust funds or property; knowledge acquired by a beneficiary concerning a trustee's unauthorized disposal or conversion of trust funds; declarations by a trustee denying the trust; or termination of the trust by lapse of time. For example, one court found that a beneficiary's claim was barred by limitations where she filed suit four years and three months after executors and trustees had refused her demand for payment under the terms of the will (four-year limitations period applied). *Anderson v. Hunt,* 122 S.W.2d 345, 347-348 (Tex. Civ. App.--Fort Worth 1938, writ ref'd). In another case, the court found that a son's claim that certain property was held in trust for him by his father was barred by limitations as a matter of law, where the son's affidavit stated that the father had repudiated the trust and used and claimed the property as his own more than nine years before the suit was filed. *Mueller v. Banks,* 300 S.W.2d 762, 764-765 (Tex. Civ. App.--San Antonio 1957, writ ref'd n.r.e.). Finally, in another case, a court held that the statute of limitations began running on the date that the trust was terminated. *Guardian Trust Co. v Studdert,* 36 S.W.2d 578, 584 (Tex. Civ. App.--Beaumont, 1931), aff'd, 55 S.W.2d 550 (1932). In this case, a buyer of stock was to hold all stock dividends in trust for five years to give to the seller as partial payment towards his debt for the purchase. In addition to the dividends, the buyer was to make payments on the note from his own funds. At the end of the five-year period the parties settled the trust; the buyer handed over the five years of dividends while still owing about half of the purchase price. The Texas Supreme Court held that where the settlement between the buyer and seller terminated the express trust, a debtor-creditor relationship was created and the statute of limitations began to run. *Guardian Trust Co.*, 36 S.W.2d at 584, 585. These cases give examples of the types of acts that courts consider sufficient notice to start the statutes of limitations running.

14.1.9.3 **No Notice of Breach:** In comparison, the courts do not consider the following sufficient notice of breach: mere possession of trust property by a trustee; mere payment of taxes by the trustee in his individual capacity; actions by the trustee in accordance with his proscribed authority to control, manage, or dispose of property; legal title remaining in the trustee for a considerable period after the beneficiary was entitled to demand same; and acts of repudiation by the trustee where the beneficiaries do not know that a trust exists. Thus, one court found that where a community administrator and statutory trustee had broad managerial powers, in accordance with Texas Probate Code §167, to control, manage, and dispose of community property as may seem for the best interest of the estate, the trustee's sale of the property did not serve as notice to the beneficiary sufficient to start limitations running against her claim. *Estate of D.F. Jackson,* 613 S.W.2d 80, 83-84 (Tex. Civ. App.--Amarillo 1981, writ ref'd n.r.e) In another case, the court found that where the beneficiaries of a trust had no knowledge that the trust existed, the trustee could not start limitations running by claiming and using the property as his own. *Rice v. Ward,* 51 SW 844, 845 (Tex. 1899). Finally, in a claim against a trustee for breach in distribution of trust funds, a court ruled that limitations began to run when the beneficiary first

learned of the payment of funds and not on the date the check was issued (seven months earlier). *Flowers v. Collins*, 357 S.W.2d 179, 181 (Tex. Civ. App.--Austin 1962, writ dism'd). In sum, for limitations to run, the beneficiary must know of the existence of the trust, and he or she must have knowledge of a breach or of other actions by the trustee that are adverse to his or her claim.

When determining whether a beneficiary had knowledge of a breach or of facts sufficient to excite inquiry, one must take into consideration the fiduciary relationship of the parties. In actions against trustees, there is no duty on the part of the beneficiary to investigate, at least until he has knowledge of facts sufficient to excite inquiry. See *Courseview v. Phillips*, 312 S.W.2d 197, 205 (Tex. 1957). A fiduciary relationship is one of the circumstances to be considered in determining whether fraud might have been discovered by the exercise of reasonable diligence. Where a relationship of trust and confidence exists one may not exact as prompt or as diligent an investigation as might otherwise be expected. *Id.*

14.1.9.4 **No duty to investigate:** Where a fiduciary relationship exists, courts have generally found that no duty to investigate exists. Examples include: where a trustee uses the property as his own but assures the beneficiaries that he or she is holding the property in trust for them; where the beneficiaries know that the trustee is exercising control over trust funds and property but do not know that he is using them for his own gain; and, where the beneficiaries had access to records that if examined would have uncovered the breach. For example, in one case, a trustee used trust funds to make investments, sold the investments for a profit, and then returned the principal with legal interest to the trust, keeping the excess. *Slay v. Burnett Trust*, 187 S.W.2d, at 393. The Texas Supreme Court held that the fact that the beneficiaries and co-trustees had knowledge of the former trustee's involvement with the investment venture, and the fact of the existence of records in the office of trust showing the issuance by the trust of two checks (with notations indicating that they were used by the trustee for expenses in litigation concerning the investment) was not sufficient to put the beneficiary or the co-trustees on inquiry. *Id.* at 394. In another case, the court found limitations did not bar a claim where a trustee had used property as his own and kept the income received therefrom, but had made the beneficiaries believe that his conduct was not adverse to their interest by giving repeated assurances that he was holding the property for their benefit. *Hatton v. Turner*, 622 S.W.2d 450, 459 (Tex. Civ. App.--Tyler 1981, no writ). Courts believe that it is more reasonable for a beneficiary to trust one with whom he or she shares a relationship of trust than if an arms-length relationship were involved.

14.1.9.5 **Investigation reasonable:** Where there is a duty to review or oversee trust transactions, as in the case of co-trustees, or subsequent trustees and executors, a court may find that the existence of evidence in the trust records showing discrepancies or fraud should have been discovered by due diligence. Moreover, if a beneficiary gains actual knowledge of facts sufficient to alert him or her that the trustee is not holding the property for the beneficiary's benefit, the beneficiary will then be required to investigate. In one case, a court found that the beneficiaries' and subsequent trustees' claims against two former executrix-trustees were barred by limitations where, at the time the subsequent trustees were appointed (about 12 years before this suit was filed), various information, reflecting the discrepancies on which the claim was based, was available and in the possession of the claimants. *InterFirst Bank-Houston, v. Quintana Petroleum*, 699 S.W.2d

864, 875 (Tex. App.--Houston [1st Dist.] 1985, writ ref'd n.r.e). This information included: the inventory, appraisal, and lists of claims for the estate; the estate tax returns, financial statements, and audit reports; and an accounting made in preparation for other litigation. The court stated:

> There is no harshness in holding that the [subsequent trustees] are charged with: knowledge of the gifts made to the trusts that they are administering by the testator's will; the information furnished by the inventory and appraisal filed in the testator's estate; the various properties transferred from the estate into the trust that they are administering; and, the content of the audits made by previous trustees. The information furnished from these sources in this case is sufficient as a matter of law to require the trustee to begin an inquiry, and the record shows that a diligent inquiry would have led to the discovery of the "self-dealing" transaction about which [the] complaint has been made. (punctuation added)

Id. at 876. The court stated that because a trustee was the proper party to bring an action against the executrices in this case, the period of limitations should be computed from the time the subsequent trustees should have known of the breach. *Id.* at 874. Thus, had the subsequent trustees adequately performed their duties in administering the trust, they would have examined documents revealing certain discrepancies. Then, with this knowledge of facts sufficient to excite inquiry, they would be under a duty to investigate, and the statute of limitations would begin to run.

A beneficiary must gain actual or constructive notice of a breach in order for the statute of limitations to run. Generally this must include knowledge of acts that are adverse to the beneficiary's claim and that exceed the trustee's authority to control, manage, or dispose of trust funds or property. The acts must be sufficiently definite to inform the beneficiary that the trustee is no longer holding the property for his or her benefit. Because of the fiduciary relationship between a trustee and a beneficiary, the beneficiary is under no duty to investigate the trustee's actions, at least until he acquires knowledge of facts sufficient to excite inquiry. Therefore, the existence of records that may reveal a breach do not begin the running of limitations unless the beneficiary is under some other duty to examine or oversee trust transactions, or if the beneficiary gains actual knowledge of the transactions through other means.

14.1.9.6 **Limitations Period:** §16.004 of the Texas Civil Practice and Remedies Code provides that:

> (a) A person must bring suit on the following actions not later than four years after the day the cause of action accrues: ...
>
> (5) breach of fiduciary duty.

14.1.9.7 **Effect of Disability on Limitations Period:** §16.001 of the Texas Civil Practice and Remedies Code provides that:

> (a) For the purposes of this subchapter, a person is under a legal disability if the person is:

(1) younger than 18 years of age, regardless of whether such person is married; or

(2) of unsound mind.

(b) If a person entitled to bring a personal action is under a legal disability when the cause of action accrues, the time of the disability is not included in a limitations period.

(c) A person may not tack one legal disability to another to extend a limitations period.

(d) A disability that arises after a limitations period starts does not suspend the running of the period.

14.1.10 **Subsequent Affirmance:**

14.1.10.1 **Texas Law:** See Tex. Prob. Code Ann. §114.005 *supra*.

14.1.10.2 **Other Authorities:** *Restatement of Trusts, 2d, supra* §218 provides that:

Discharge of Liability by Subsequent Affirmance

(1) Except as stated in Subsection (2), if the trustee in breach of trust enters into a transaction which the beneficiary can at his potion reject or affirm, and the beneficiary affirms the transaction, he cannot thereafter reject it and hold the trustee liable for any loss occurring after the trustee entered into the transaction.

(2) The affirmance of a transaction by the beneficiary does not preclude him from holding the trustee liable for a breach of trust, if at the time of the affirmance:

(a) the beneficiary was under an incapacity; or

(b) the beneficiary did not know of his rights and of the material facts which the trustee knew or should have known and which the trustee knew or should have known and which the trustee did not reasonably believe that the beneficiary knew; or

(c) the affirmance was induced by improper conduct of the trustee; or

(d) the transaction involved a bargain with the trustee which was not fair and reasonable.

See also *Scott, supra* §218.

14.1.11 **Miscellaneous Statutory Defenses:**

14.1.11.1 **Tex. Trust Code §114.003:** provides that:

If a trust instrument reserves or vests authority in any person to the exclusion of the trustee, including the settlor, an advisory or investment committee, or one or more cotrustees, to direct the making or retention of an investment or to perform any other act

> in the management or administration of the trust, the excluded trustee or cotrustee is not liable for a loss resulting from the exercise of the authority in regard to the investments, management, or administration of the trust.

14.1.11.2 **Tex. Trust Code §114.004** provides that:

> A trustee is not liable for a mistake of fact made before the trustee has actual knowledge or receives a written notice of the happening of any event that determines or affects the distribution of the income or the principal of the trust, including marriage, divorce, attainment of a certain age, performance of education requirements, or death.

15 DISCOVERY:

15.1 DISCOVERY BY A BENEFICIARY FROM A TRUSTEE:

15.1.1 As set forth above, a trustee has a fiduciary duty to disclose information to the beneficiary and to allow the beneficiary to examine the books and records of the trust. Given these fiduciary duties, a beneficiary should be entitled to two forms of discovery against a trustee:

15.1.1.1 **With Respect to the Books and Records of the Trust and Information Relating to the Administration of the Trust**: The beneficiary should only have to informally request this information from the trustee. The trustee's compliance with this type of request should be governed by the rules of equity. If the trustee refuses to provide this information this should constitute a separate breach of trust.

> It should be stressed, however that this distinction is lost on many courts. Most judges are used to handling discovery issues pursuant to the traditional rules contained in the Texas Rules of Civil Procedure and are usually reluctant to recognize any equitable rights to information or to impose any equitable remedies for the breach of fiduciary duty to disclose information.

15.1.1.2 **With Respect to the individual books and records of the trustee**: With respect to proprietary information of the trustee the beneficiary should utilize the discovery rules set forth in the Texas Rules of Civil Procedure.

15.2 **DISCOVERY BY A TRUSTEE:** The trustee's discovery from a beneficiary is governed by the Texas Rules of Civil Procedure.

16 REMEDIES:

16.1 **GENERAL CONSIDERATIONS:** As previously discussed, remedies involving trusts are equitable remedies rather than legal remedies. If the lawsuit is against multiple defendants then attention must be given to the following provisions of the Texas Civil Practice and Remedies Code:

16.1.1 **Comparative Liability:** Is governed by CPRC Chapter 33. Comparative Liability provisions only apply to "any cause of action based on tort in which a defendant, settling person, or responsible third party is found responsible for a percentage of the harm for which relief is sought" and actions brought under the Texas Deceptive Trade Practices-Consumer Protection Act. It should not apply to equitable causes of action. As previously mentioned, however, trial judges and appellate courts often do not make this distinction.

16.1.2 **Contribution:** Is governed by CPRC Chapter 32. Contribution only applies to "tort actions". It should not apply to equitable causes of action. As previously mentioned, however, trial judges and appellate courts often do not make this distinction.

16.2 **MONETARY DAMAGES:**

16.3 Texas Trust Code §114.001 provides for the damages that can be recovered by a beneficiary from the trustee. This section provides that:

> (a) The trustee is accountable to a beneficiary for the trust property and for any profit made by the trustee through or arising out of the administration of the trust, even though the profit does not result from a breach of trust; provided, however, that the trustee is not required to return to a beneficiary the trustee's compensation as provided by this subtitle, by the terms of the trust instrument, or by a writing delivered to the trustee and signed by all beneficiaries of the trust who have full legal capacity.
>
> (b) The trustee is not liable to the beneficiary for a loss or depreciation in value of the trust property or for a failure to make a profit that does not result form a failure to perform the duties set forth in this subtitle or from any other breach of trust.
>
> (c) A trustee who commits a breach of trust is chargeable with any damages resulting from such breach of trust, including but not limited to:
>
> > (1) any loss or depreciation in value of the trust estate as a result of the breach of trust;
> >
> > (2) any profit made by the trustee through the breach of trust;
> >
> > (3) any profit that would have accrued to the trust estate if there had been no breach of trust.
>
> (d) The trustee is not liable to the beneficiary for a loss or depreciation in value of the trust property or for acting or failing to act under Section 113.025 or under any other provision of this subtitle if the action or failure to act relates to compliance with an environmental law and if there is no gross negligence or bad faith on the part of the trustee. The provision of any instrument governing trustee liability does not increase the liability of the trustee as provided by this section unless the settlor expressly makes reference to this subsection.
>
> (e) The trustee has the same protection from liability provided for a fiduciary under 42 USCA Section 9607 (n).

16.4 **EXEMPLARY DAMAGES**:

16.4.1 Exemplary damages are recoverable for breach of trust. *InterFirst Bank Dallas, N.A. v. Risser*, 739 S.W.2d 882 (Tex. App.--Texarkana, 1987, Reh'g Denied).

16.4.2 Many aspects of the recovery of exemplary damages are covered by CPRC Chapter 41.

16.4.2.1 This chapter sets forth the standards for recovery of exemplary damages (CPRC §41.003):

> (a) Except as provided by Subsection (c), exemplary damages may be awarded only if the claimant proves by clear and convincing evidence that the harm with respect to which the claimant seeks recovery of exemplary damages results from:
>
> (1) fraud;

(2) malice; or

(3) gross negligence.

(b) The claimant must prove by clear and convincing evidence the elements of exemplary damages as provided in this section. This burden of proof may not be shifted to the defendant or satisfied by evidence of ordinary negligence, bad faith, or a deceptive trade practice.

(c) If the claimant relies on a statute establishing a cause of action and authorizing exemplary damages in specified circumstances or in conjunction with a specified culpable mental state, exemplary damages may be awarded only if the claimant proves by clear and convincing evidence that the damages result from the specified circumstances or culpable mental state.

(d) Exemplary damages may be awarded only if the jury was unanimous in regard to finding liability for and the amount of exemplary damages.

(e) In all cases where the issue of exemplary damages is submitted to a jury, the following instruction shall be included in the charge of the court:

"You are instructed that, in order for you to find exemplary damages, your answer to the question regarding the amount of such damages must be unanimous."

16.4.2.2 There is now a statutory limit on the amount of recovery for exemplary damages. This limit is contained in CPRC §41.008 which provides, in part, that:

(a) In an action in which a claimant seeks recovery of damages, the trier of fact shall determine the amount of other compensatory damages.

(b) Exemplary damages awarded against a defendant may not exceed an amount equal to the greater of:

(1)(A) two times the amount of economic damages; plus

(B) an amount equal to any noneconomic damages found by the jury, not to exceed $750,000; or
(2) $200,000.

(c) This section does not apply to a cause of action against a defendant from whom a plaintiff seeks recovery of exemplary damages based on conduct described as a felony in the following sections of the penal code if, except for Sections 49.07 and 49.08, the conduct was committed knowingly or willingly;

...(10) Section 32.45 (misapplication of fiduciary property .

16.5 REMOVAL:

16.5.1 Texas Trust Code §113.082 deals with the removal of a trustee and provides that:

> (a) A trustee may be removed in accordance with the terms of the trust instrument, or, on the petition of an interest person and after hearing a court may, in its discretion, remove a trustee and deny part or all of the trustee's compensation if:
>
> > (1) the trustee materially violated or attempted to violate the terms of the trust and the violation or attempted violation results in a material financial loss to the trust;
> >
> > (2) the trustee becomes incompetent or insolvent;
> >
> > (3) the trustee fails to make an accounting that is required by law or by the terms of the trust; or
> >
> > (4) in the discretion of the court, for other cause.
>
> (b) A beneficiary, co-trustee, or successor trustee may treat a violation resulting in removal as a breach of trust.
>
> (c) A trustee of a charitable trust may not be removed solely on the grounds that the trustee exercised the trustee's power to adjust between principal and income under Section 113.0211.

16.6 **FORFEITURE OF COMPENSATION**: Texas Trust Code §113.082 provides that in connection with a removal action a court may deny part or all of the trustee's compensation.

16.6.1 The standards for disgorgement of fees are set forth in detail by the court in the case of *Burrow v. Arce*, 997 S.W.2d. 229 (Tex. 1999). In this case the Texas Supreme Court held that:

> To determine whether actual damages are a prerequisite to forfeiture of an attorney's fee, we look to the jurisprudential underpinnings of the equitable remedy of forfeiture. The parties agree that as a rule a person who renders service to another in a relationship of trust may be denied compensation for his service if he breaches that trust. Section 243 of the Restatement (Second) of Trusts states the rule for trustees: "If the trustee commits a breach of trust, the court may in its discretion deny him all compensation or allow him a reduced compensation or allow him full compensation." [FN26] Similarly, section 469 of the Restatement (Second) of Agency provides:
>
> An agent is entitled to no compensation for conduct which is disobedient or which is a breach of his duty of loyalty; if such conduct constitutes a wilful and deliberate breach of his contract of service, he is not entitled to compensation even for properly performed services for which no compensation is apportioned. ...
>
> Though the historical origins of the remedy of forfeiture of an agent's compensation are obscure, the reasons for the remedy are apparent. The rule is founded both on principle and pragmatics. In principle, a person who agrees to perform compensable services in a relationship of trust and violates that relationship breaches the agreement, express or implied, on which the right to compensation is based. The person is not entitled to be paid when he has not provided the loyalty bargained for and promised. Thus, for example, comment a to section 243 of the Restatement (Second) of Trusts explains:

> When the compensation of the trustee is reduced or denied, the reduction or denial is not in the nature of an additional penalty for the breach of trust but is based upon the fact that the trustee has not rendered or has not properly rendered the services for which compensation is given.

Along the same lines, comment b to section 49 of the proposed Restatement (Third) of The Law Governing Lawyers explains: "The remedy of fee forfeiture presupposes that a lawyer's clear and serious violation of a duty to a client destroys or severely impairs the client-lawyer relationship and thereby the justification of the lawyer's claim to compensation." [FN30] Pragmatically, the possibility of forfeiture of compensation discourages an agent from taking personal advantage of his position of trust in every situation no matter the circumstances, whether the principal may be injured or not. The remedy of forfeiture removes any incentive for an agent to stray from his duty of loyalty based on the possibility that the principal will be unharmed or may have difficulty proving the existence or amount of damages.

In other words, as comment b to section 49 of the proposed Restatement (Third) of The Law Governing Lawyers states, "[f]orfeiture is also a deterrent."

To limit forfeiture of compensation to instances in which the principal sustains actual damages would conflict with both justifications for the rule. It is the agent's disloyalty, not any resulting harm, that violates the fiduciary relationship and thus impairs the basis for compensation. An agent's compensation is not only for specific results but also for loyalty. Removing the disincentive of forfeiture except when harm results would prompt an agent to attempt to calculate whether particular conduct, though disloyal to the principal, might nevertheless be harmless to the principal and profitable to the agent. The main purpose of forfeiture is not to compensate an injured principal, even though it may have that effect. Rather, the central purpose of the equitable remedy of forfeiture is to protect relationships of trust by discouraging agents' disloyalty.

In the one case in which we have considered the subject, *Kinzbach Tool Co. v. Corbett-Wallace Corp*., this Court held that an agent was required to forfeit a secret commission received from a conflicting interest even though the principal was unharmed. There, an oil field tool company, Corbett- Wallace, wanted to sell its sales rights contract on a patented tool, the whipstock, to another company, Kinzbach Tool, and was willing to go as low as $20,000 on the price. Corbett-Wallace contacted a Kinzbach Tool employee, Turner, and offered him a secret commission if he could get Kinzbach Tool to buy the whipstock contract. Corbett-Wallace instructed Turner not to disclose its bottom-line price to his employer but to get as large an offer as possible. Turner approached his superiors about buying the contract without disclosing his conversations with Corbett-Wallace or the price it was willing to take. Turner's superiors told him that Kinzbach Tool would pay as much as $25,000 for the contract and asked him to find out what price Corbett-Wallace would take. Turner did not tell his employer that Corbett-Wallace was willing to accept $5,000 less than

Kinzbach Tool was willing to offer. Kinzbach Tool bought the whipstock contract for $25,000, payable in installments, and Corbett-Wallace agreed to pay Turner a $5,000 commission. When Kinzbach Tool learned of Turner's secret commission arrangement, it sued Corbett- Wallace and Turner, claiming that the secret commission should be credited to the sale price. We agreed, holding that Turner had breached his fiduciary duty to his employer. Rejecting Corbett-Wallace's argument that the commission should not be forfeited because Kinzbach Tool paid no more for the whipstock contract than it was worth, we explained:

> It is beside the point for either Turner or Corbett to say that Kinzbach suffered no damages because it received full value for what it has paid and agreed to pay. A fiduciary cannot say to the one to whom he bears such relationship: You have sustained no loss by my misconduct in receiving a commission from a party opposite to you, and therefore you are without remedy. It would be a dangerous precedent for us to say that unless some affirmative loss can be shown, the person who has violated his fiduciary relationship with another may hold on to any secret gain or benefit he may have thereby acquired. It is the law that in such instances if the fiduciary "takes any gift, gratuity, or benefit in violation of his duty, or acquires any interest adverse to his principal, without a full disclosure, it is a betrayal of his trust and a breach of confidence, and he must account to his principal for all he has received."

Texas courts of appeals, as well as courts in other jurisdictions and respected commentators, have also held that forfeiture is appropriate without regard to whether the breach of fiduciary duty resulted in damages.

The Attorneys nevertheless argue that forfeiture of an attorney's fee without a showing of actual damages encourages breach-of-fiduciary claims by clients to extort a renegotiation of legal fees after representation has been concluded, allowing them to obtain a windfall. The Attorneys warn that such opportunistic claims could impair the finality desired in litigation settlements by leaving open the possibility that the parties, having resolved their differences, can then assert claims against their counsel to obtain more than they could by settlement of the initial litigation. The Attorneys urge that a bright-line rule making actual damages a prerequisite to fee forfeiture is necessary to prevent misuse of the remedy. We disagree. Fee forfeiture for attorney misconduct is not a windfall to the client. An attorney's compensation is for loyalty as well as services, and his failure to provide either impairs his right to compensation. While a client's motives may be opportunistic and his claims meritless, the better protection is not a prerequisite of actual damages but the trial court's discretion to refuse to afford claimants who are seeking to take unfair advantage of their former attorneys the equitable remedy of forfeiture. Nothing in the case law in Texas or elsewhere suggests that opportunistically motivated litigation to forfeit an agent's fee has ever been a serious problem.

The Attorneys also argue that without a determination of a client's actual damages there is nothing to measure whether the fee forfeiture is excessive in a case. The Attorneys point out that one measure of whether punitive damages are excessive is the amount of

> actual damages awarded. While this is true, forfeiture of an agent's compensation is not mainly compensatory, as we have already noted, nor is it mainly punitive. Forfeiture may, of course, have a punitive effect, but that is not the focus of the remedy. Rather, the central purpose of the remedy is to protect relationships of trust from an agent's disloyalty or other misconduct. Appropriate application of the remedy cannot therefore be measured by a principal's actual damages. An agent's breach of fiduciary duty should be deterred even when the principal is not damaged.
>
> We therefore conclude that a client need not prove actual damages in order to obtain forfeiture of an attorney's fee for the attorney's breach of fiduciary duty to the client.
>
> The Clients argue that an attorney who commits a serious breach of fiduciary duty to a client must automatically forfeit all compensation to the client. This, the Clients contend, is the import of our decision in Kinzbach and is necessary to thoroughly discourage attorney misconduct. But Kinzbach did not involve issues of whether forfeiture should be limited by circumstances or in amount. The agent there intentionally breached his fiduciary duty in a single, narrow transaction, and his only compensation was a commission. Our holding that his entire compensation was subject to forfeiture cannot fairly be said to require automatic, complete forfeiture of all compensation for any misconduct of an agent. Nor is automatic and complete forfeiture necessary for the remedy to serve its purpose. On the contrary, to require an agent to forfeit all compensation for every breach of fiduciary duty, or even every serious breach, would deprive the remedy of its equitable nature and would disserve its purpose of protecting relationships of trust. A helpful analogy, the parties agree, is a constructive trust, of which we have observed:
>
> Constructive trusts, being remedial in character, have the very broad function of redressing wrong or unjust enrichment in keeping with basic principles of equity and justice.... Moreover, there is no unyielding formula to which a court of equity is bound in decreeing a constructive trust, since the equity of the transaction will shape the measure of relief granted.
>
> Like a constructive trust, the remedy of forfeiture must fit the circumstances presented. It would be inequitable for an agent who had performed extensive services faithfully to be denied all compensation for some slight, inadvertent misconduct that left the principal unharmed, and the threat of so drastic a result would unnecessarily and perhaps detrimentally burden the agent's exercise of judgment in conducting the principal's affairs.

16.7 **LEGAL FEES**:

16.7.1 With Respect To “Proceedings Under The Texas Trust Code”: Texas Trust Code §114.064 is the section of the Trust Code that governs the award of legal fees. This section was taken from the Texas Uniform Declaratory Judgments Act (§37.009) and provides that:

> In any proceeding under this code the court may make such award of costs and reasonable and necessary attorney’s fees as may seem equitable and just.

See also: *Conte v. Conte,* 56 S.W.3d 830 (Tex. App. - Houston [1st Dist] 2001, no writ); *Hershbach v. City of Corpus Christi,* 883 S.W.2d 720 (Tex. App. - Corpus Christi, *writ denied*); *Lyco Acquisiton 1984 Ltd. P'ship v. First Nat'l Bank of Amarillo,* 860 S.W. 2d. 117 (Tex. App. - Amarillo 1993, *writ denied*); *Texarkana National Bank v. Brown,* 920 F. Supp. 706 (E.D. Tex 1996)

Applicability of Tex. Trust Code §114.064: The Houston Court of Appeals [14th Dist.] has held that:

> We begin with the rule that attorney's fees may not be recovered unless provided for by statute or contract *Dallas Cent. Appraisal Dist. v. Seven Inv. Co.,* 835 S.W.2d 75 (Tex. 1992). Statutory provisions for the recovery of attorney's fees must be strictly construed because they are penal in nature and are in derogation of the common law. New Amsterdam Cas. Co. v. Texas Ind., Inc. , 414 S.W.2d 914, 915 (Tex. 1967). An award of attorney's fees may not be supplied by implication but must be provided for by the express terms of the statute in question. *First City Bank – Farmers Branch, Texas v. G,* 677 S.W.2d 25, 30 (Tex. 1984).

16.7.2 **Collecting Legal Fees Without a Fee Contract**:

16.7.2.1 **Quantum Meruit**:

16.7.2.1.1 *Enochs v. Brown* , 872 S.W.2d 312 (Tex. App. – Austin 1994, no writ):

> To recover under quantum meruit, a claimant must prove that: (1) valuable services were rendered; (2) for the person sought to be charged; (3) the services were accepted, used, and enjoyed by the person sought to be charged; and (4) the acceptance, use, and enjoyment was under such circumstances as reasonably notified the person sought to be charged that the claimant, in performing such services, was expecting to be paid by the person sought to be charged. *Vortt Exploration Co. v. Chevron U.S.A.,* 787 S.W.2d 942, 944 (Tex. 1990)

16.7.2.2 **Quasi-estoppel:**

16.7.2.2.1 In *Enochs, supra* the client signed a contingent fee contract and, after the attorney had fully performed under the contract and had obtained a recovery, claimed that the contract was void under Government Code §82.065(a) because it was not signed by the attorney. The *Enochs* court held that:

> These findings support the theory of quasi-estoppel. The principle of quasi-estoppel precludes a party from asserting, to another's disadvantage, a right inconsistent with a position he has previously taken. *Steubner Realty 19, Ltd. v. Cravens Rd. 88, Ltd*, 817 S.W.2d 160, 164 (Tex. App. – Houston [14th Dist.] 1991, no writ) (citation omitted) The doctrine applies when it would be unconscionable to allow a person to maintain a position inconsistent with one in which he accepted a benefit. *Id*. Misrepresentation by one party, and reliance by the other are not necessary elements of quasi-estoppel.

16.7.2.3 **Common Fund Doctrine** :

16.7.2.3.1 Knebel v. Capital National Bank In Austin, 518 S.W.2d 795 (Tex. 1974):

> Based on their successful litigation in nullifying the stock redemption sale and the claimed benefit to the estate and its beneficiaries therefrom, Herbert Knebel, *et al.*, invoked the rule of the "common fund" doctrine. They sought reimbursement from the Knebel estate for the fees they were contractually bound to pay their attorneys under their contingent fee contracts, and an additional recovery for the use and benefit of their attorneys.
> **The rule thus invoked rests in equity and not contract in charging a common fund with expenses, including attorney's fees. The equitable objective is that of distributing the burden of such expenses among those who share in an accomplished benefit.** (emphasis supplied)

16.8 COSTS:

16.8.1 Tex. Trust Code §114.064: provides that:

> In any proceeding under this code the court may such award of **costs** and reasonable and necessary attorney's fees as may seem equitable and just. (emphasis supplied)

16.8.2 **What Are Costs?**: Costs are described in the Texas Civil Practice And Remedies Code §31.007 to be:

> (1) fees of the clerk and service fees due the county;
>
> (2) fees of the court reporter for the original of stenographic transcripts necessarily obtained for use in a suit;
>
> (3) masters, interpreters, and guardians ad litem appointed pursuant to these rules and state statutes; and
>
> (4) such other costs and fees as may be permitted by these rules and state statutes.

16.8.2.1 A guardian ad litem appointed pursuant to Tex. Trust Code §115.014 may be authorized to retain legal counsel to represent him (See the discussion of ad litem's above). If this is the case, are the guardian's legal fees and litigation costs "costs" under the rules? Because Tex. Trust Code §114.064 allows the court to award both costs and "legal fees" (without specifying who's legal fees) this is probably a distinction without a difference in trust litigation. The court can probably award the ad litem's attorneys fees and litigation expenses as either costs or attorney's fees.

16.8.3 TRCP Rule 125: provides that:

> Each party to as suit shall be liable to the officers of the court for all costs incurred by himself.

16.8.4 TRCP Rule 127: provides that:

> Each party to a suit shall be liable for all costs incurred by him. If the costs cannot be collected from the party against whom they have been adjudged, execution may issue against any party in such suit for the amount of costs incurred by such party, but no more.

16.8.5 TRCP Rule 129 provides that:

> If any party responsible for costs fails or refuses to pay the same within ten days after demand for payment, the clerk or justice of the peace may make certified copy of the bill of costs then due, and place the same in the hands of the sheriff or constable for collection. All taxes imposed on law proceedings shall be included in the bill of costs. Such certified bill of costs shall have the force and effect of an execution. The removal of a case by appeal shall not prevent the issuance of an execution for costs.

16.8.6 TRCP Rule 131: provides that:

> The successful party to a suit shall recover of his adversary all costs incurred therein, except where otherwise provided.