TRUST LITIGATION
SUING AND DEFENDING A TRUSTEE FOR BREACH OF FIDUCIARY DUTY

Presented To:

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TRUST LITIGATION FROM THE PERSPECTIVE OF BOTH THE PLAINTIFF AND THE DEFENDANT

PART ONE - FIDUCIARY DUTIES

I. TRUSTEES AS FIDUCIARIES

A. A Trustee is a Fiduciary

A trustee, once he has accepted appointment, is in a fiduciary relation to the beneficiaries of the trust. See *A. Scott & W. Fratcher,* The Law of Trusts § 170, American Law Institute, *Restatement (Second) of Trusts*, § 2 (1980).

B. Trustees are Subject to Fiduciary Duties

Trustees are subject to the duties imposed by the common law, the duties imposed by the Texas Trust Code and the duties imposed by the instrument creating the Trust. Tex. Trust Code Ann. § 113.051 (Vernon 1984).

C. Scope of This Paper

Suits against trustees may take several forms. A suit may be brought as an action for breach of contract, as an action in tort, as an action in equity, or as an action for declaratory judgment. Virtually every such action will seek to impose liability against the trustee for a breach of fiduciary duty. In order to avoid liability a trustee must both have a clear understanding of his fiduciary duties and strictly comply with them. While causes of action that do not involve breach of fiduciary duty may be brought against a trustee (such as actions for breach of the Texas Deceptive Trade Practices Act) these are so rare that they are dealt with only tangentially in this paper. The principal thrust of this paper is directed toward actions against a trustee for breach of fiduciary duty.

II. GENERAL TYPES OF FIDUCIARY DUTIES

A. Distinction Between “Powers” and “Duties”

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.

2. For example, if a trust instrument purports to 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?

3. 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.

4. 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.

2. Common Law Fiduciary Duties

1. 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.

C. Statutory Fiduciary Duties

1. Statutory fiduciary duties are duties that have been created by the legislature to apply to certain designated types of fiduciaries. These duties apply to the type of fiduciary specifically enumerated by the statute.

2. There may be a considerable overlap between a common law fiduciary duty and a statutory fiduciary duty (e.g. the Texas Trust Code contains a "prudent man rule" that is very similar to the common law prudent man rule). When such overlap occurs the statutory duty will take precedence over the common law duty.

3. 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 Ann. § 111.005 (Vernon 1984);

and Trust Code § 113.051 provides:

> 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 by trustees by the common law. Tex. Trust Code Ann. § 113.051 (Vernon 1984)

4. <u>Fiduciary Duties Created by the Instrument</u>

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

2. 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 contain a prudent man rule that is slightly different from both the statutory prudent man rule contained in the Texas Trust Code and 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. An instrument may not, however, relieve a fiduciary from liability for self dealing, actions taken in bad faith or for

acting intentionally adverse or with reckless indifference to the interests of a beneficiary.

III. FIDUCIARY DUTIES

A. Duty to Exercise Ordinary Skill and Prudence (the "Prudent Man Rule")

1. The common law duty.

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.); Bogert & Bogert, *The Law of Trusts and Trustees* § 12 (2nd ed. 1985) § 541; *Scott, supra,* § 174; Restatement (Second) of Trusts, *supra,* § 174.

2. The statutory duty of a trustee.

Texas Trust Code § 113.056(a) provides:

> Unless the terms of the trust instrument provide otherwise, in acquiring, investing, reinvesting, exchanging, retaining, selling, supervising and managing trust property . . . a trustee shall exercise the judgment and care under the then prevailing circumstances that persons of ordinary prudence, discretion, and intelligence exercise in the management of their own affairs, not in regard to speculation but in regard to the permanent disposition of their funds, considering the probable income from as well as the probable increase in value and safety of their capital. In determining whether a trustee has exercised prudence with respect to an investment decision, such determination shall be made taking into consideration the investment of all the assets of the trust, or the assets of the collective

> investment vehicle, as the case may be, over which the trustee had management and control, rather than a consideration as to the prudence of a single investment of the trust, or the single investment of the collective investment vehicle as the case may be. (emphasis supplied) Tex. Trust Code Ann. § 113.056(a) (Vernon Supp. 1991) as amended by Act of June 16, 1991, 72nd. Leg., 1st C.S., Ch. 876, 1991 Tex. Sess. Law Serv. 2987 (Vernon).

In 1991 the Texas Legislature amended Texas Trust Code § 113.056(a) to provide that in a suit for breach of the duty of prudence the jury may consider "the investment of all the assets of the trust . . . over which the trustee had control, rather than a consideration . . . of a single investment." Prior to this amendment Texas followed the common law "single investment test." This test provided that the prudence of each individual investment was judged separately from each other investment in the portfolio. The single investment test is probably still the law in Texas with the exception that the jury must now consider the investment performance of the entire portfolio in determining whether a single investment violates the prudent man rule. The 1991 amendment to the prudent man rule did not go so far as to impose the "portfolio investment test." Under this test the liability of the fiduciary would be determined on the basis of whether or not the investment of the entire portfolio were prudent (and the prudence of an individual investment could not be considered).

3. Speculative Investments.

As a general rule, a trustee may not engage in speculative investments. *Nathan v. Hudson*, 376 S.W.2d 856 (Tex.Civ.App -- Dallas 1964, writ ref'd n.r.e.); *Merrill, Lynch, Pierce, Fenner & Smith, Inc. v. Bocock*, 247 F. Supp. 373 (S.D. Tex. 1965). See also *Scott, supra* § 612 and Tex. Trust Code Ann. § 113.056(a) (Vernon Supp. 1991).

Although a testator, grantor, co-trustee, beneficiary or distributee may legally authorize the trustee to participate in speculative investments, the fact remains that any trustee making speculative investments does so at his own risk. If the speculative investment results in a loss, the fiduciary may be confronted with

litigation based on 20/20 hindsight by a jury. Even if the investment was authorized by a beneficiary, the trustee may face the argument that if the trustor had wanted the beneficiary to make investment decisions then he would have designated such person as trustee.

4. Diversification.
The *Restatement (Second) of Trusts, supra* § 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.

B. Duty of Loyalty

1. The common law duty.

The common law duty of loyalty is basically as follows:

> One of the most fundamental duties of the 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.

Bogert, supra, § 543, *Scott, supra*, § 170; *Restatement (Second) of Trusts, supra,* § 170; *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).

By way of elaboration, some courts have stated the duty thus:

> 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.

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 . . . (citation omitted, emphasis added).

Slay v. Burnett Trust, 187 S.W.2d 377, 388 (Tex. 1945)The same court also stated:

> 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).

Slay, supra, at 389.

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).

Finally, the constructive fraud doctrine provides that if a fiduciary takes any discretionary action as a fiduciary which directly or indirectly benefits the fiduciary (or the fiduciary's family or affiliates) then the transaction is presumed fraudulent. The burden of proof then shifts to the fiduciary to provide that the transaction is fair. 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. Peckam,* 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).

2. The statutory duty of a trustee.

    1. Texas Trust Code § 113.052 provides that:

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

            (a) the trustee or an affiliate;

(b) a director, officer, or employee of the trustee or an affiliate;
(c) a relative of the trustee; or
(d) the trustee's employer, employee, partner, or other business associate.

ii. This section does not prohibit:

(a) 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
(b) a deposit by a corporate trustee with itself under Section 113.057 of this Act. Tex. Trust Code Ann. § 113.052 (Vernon 1984)

2. Texas Trust Code § 113.053 provides that:

i. 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:

(a) the trustee or an affiliate;
(b) a director, officer, or employee of the trustee or an affiliate;
(c) a relative of the trustee; or
(d) the trustee's employer, partner, or other business associate.

ii. 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:

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

(b) fixes or approves the sales price of the shares and the other terms of the sale; and
(c) enters an order authorizing and directing the sale.

iii. 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.

iv. 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.

v. A trustee may:

(a) 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
(b) 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 Section 113.056.

vi. 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:

(a) 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

(b) 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. Tex. Trust Code Ann. § 113.053 (Vernon Supp. 1991).

c. Texas Trust Code § 113.054 provides that:

1. A trustee of one trust may not sell property to another trust of which

it is also trustee unless the property is:

(a) a bond, note, bill, or other obligation issued or fully guaranteed as to principal and interest by the United States; and
(b) sold for its current market price. Tex. Trust Code Ann. § 113.054 (Vernon 1984).

4. Texas Trust Code § 113.055 provides that:

i. 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.

ii. A trustee may:

(a) retain stock already owned by the trust if the retention satisfies Section 113.056 of this Act; and
(b) exercise stock rights or purchase fractional shares under Section 113.053 of this Act. Tex. Trust Code Ann. § 113.055 (Vernon 1984).

e. Texas Trust Code § 113.057 provides:

i. 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.

ii. 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:

(a) it maintains under control of its trust department as security for the deposit a separate fund of securities legal for trust investments;

(b) the total market value of the security is at all times at least equal to the amount of the deposit; and

(c) the separate fund is marked as such.

iii. 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.

iv. 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. Tex. Trust Code Ann. § 113.057 (Vernon Supp. 1991).

3. Examples of situations where a trustee breaches his trustee duty of loyalty are:

a. A trustee buying trust property. *Bogert, supra,* § 543, page 221; see also Tex. Prob. Code Ann. § 352 (Vernon Supp. 1991); Tex. Trust Code Ann. § 113.053 (Vernon Supp. 1991).

b. A trustee leasing trust property to himself. *Bogert, supra,* § 543, page 241.

c. A trustee buying trust property at a sale forced by a third person. *Bogert, supra,* § 543, page 243.

4. a trustee buying for himself outstanding claims against interests in trust property. *Bogert, supra,* § 543, page 256.

5. A trustee selling his own property to the trust. *Bogert, supra,* § 543, page 272; see also Tex. Trust Code Ann. § 113.053 (Vernon Supp. 1991).

6. A corporate trustee buying an earmarked pool of investments for trusts. *Bogert, supra,* § 543, page 281; see also Tex. Trust Code Ann. § 113.171 (Vernon 1984).

7. A corporate trustee buying its own stock or holding its own stock for a trust. *Bogert, supra,* § 543, page 283; see also Tex. Trust Code Ann. § 113.055 (Vernon 1984).

8. A trustee of one trust selling to itself as trustee of another trust. *Bogert, supra,* § 543, page 289; see also Tex. Trust Code Ann. § 113.054 (Vernon 1984).

9. A trustee under a lease taking renewal or buying a reversion for himself. *Bogert, supra,* § 543, page 293.

10. A corporate trustee depositing trust assets with himself. Tex. Trust Code Ann. § 113.057 (Vernon Supp. 1991).

11. A corporate trustee lending its own funds to a trust. *Bogert, supra,* § 543, page 313; see also Tex. Trust Code Ann. § 113.052 (Vernon 1984); and Tex. Trust Code Ann. § 113.015 (Vernon 1984).

12. A trustee employing itself to do specialized work for the trust. *Bogert, supra,* § 543, page 319.

13. A trustee of corporate stock voting for himself as director or officer of the corporation. *Bogert, supra,* § 543, page 330.

14. A trustee of a business engaging in a competing business on his own behalf. *Bogert, supra,* § 543, page 339.

15. A trustee accepting a gift from one with whom he conducts trust business. *Bogert*, *supra,* § 543, page 343.

16. A trustee securing incidental benefit to self while engaged in trust business. *Bogert, supra*, § 543, page 344.

17. A trustee with a duty to buy for the trust purchasing for himself. *Bogert, supra*, § 543, page 353.

18. A trustee acting for the trust and also for a third party who deals with the trust. *Bogert, supra*, § 543, page 355.

19. Indirect disloyalty -- dealings with relatives, affiliated parties and similar persons. *Bogert, supra*, § 543, page 359.

20. A corporate trustee taking any action which benefits itself as a creditor, *InterFirst Bank Dallas, N.A. v. Risser*, *supra.* Such a breach would include, but not be limited to:

    i. directing distributions to a beneficiary indebted to the fiduciary,

    ii. discretionary allocations of receipts and disbursements which increase a creditor-beneficiary's distributions, and

    iii. purchases from or sales to a business entity indebted to the fiduciary.

C0 <u>Duty of Good Faith and Fair Play</u>

1 The common law duty.

By virtue of the intimate knowledge which the trustee has with respect to the financial affairs of the beneficiary, the courts impose a duty of good faith and fair play in all transactions between the fiduciary and his beneficiary. *Bogert, supra,* § 544; see *Geeslin v. McElhenney,* 788 S.W.2d 683 (Tex.App.--Austin 1990, no writ.) [dealing with an executor's duty to protect the beneficiaries' interest by fair dealing in good faith with fidelity and integrity]

2 The statutory duty of a trustee.
There are no statutory duties of good faith and fair play that specifically apply to trustees.

D0 Duty of Impartiality

1 The common law duty.

The Restatement (Second) of Trusts, supra, § 183 provides:

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

See also *Bogert, supra,* § 541, § 612; *Commercial Nat. Bank of Nacogdoches v. Hayter,* 473 S.W.2d 561 (Tex. Civ. App. 1968, writ ref'd n.r.e.)

2 The statutory duty of a trustee.

1. Texas Trust Code § 113.101 provides that:

i. A trustee shall administer the trust with due regard for the interests of income beneficiaries and remainderman with respect to the allocation of receipts and expenditures by crediting a receipt or charging an expenditure to income or principal or partly to each:

(a) in accordance with the terms of the trust instrument;
(b) in the absence of any contrary terms of the trust instrument, in accordance with this subtitle; or
(c) if neither of the preceding rules of administration is applicable, in accordance with what is reasonable and equitable in view of the interests of those entitled to income and to principal.

ii. If the trust instrument gives the trustee discretion in crediting a receipt or charging an expenditure to income or principal or partly to each, no inference arises from the

fact that the trustee makes an allocation contrary to this subtitle. Tex. Trust Code Ann. § 113.101 (Vernon 1984).

3 The duty of impartiality frequently applies to the allocation of receipts and disbursements between principal and income. The Texas Trust Code contains specific allocation provisions at §§ 113.101 - 113.111.

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

1. Investment Decisions. The decision to invest in assets for the purpose of generating either income or growth involves the fiduciary duty of impartibility. Income oriented investments favor the income beneficiary, growth oriented investments favor the remainderman. The prudent person rule contained in Texas Trust Code §113.056 is a balanced investment standard "considering the probable income therefrom as well as the probable increase in value and safety of their capital."

2. Allocation of Receipts and Disbursements. Each 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.

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.

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.

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

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

E0 Duty of Confidentiality

1 The common law duty.

2 The statutory duty of a trustee.

While there is little common law authority and no statutory authority for this duty, it is the author's opinion that a fiduciary is under a duty not to divulge confidential information regarding the fiduciary relationship.

F0 Duty to Take Possession of the Trust Property

1 The common law duty.

A trustee is under a duty to take reasonable steps to take and keep possession of and keep control of trust property, *Restatement (Second) of Trusts, supra* § 175; *Bogert, supra,* § 583; *Scott, supra,* § 175.

2 The statutory duty of a trustee.

There is no statutory duty to take possession of trust property that specifically applies to trustees.

G0 Duty to Segregate Trust Assets and Not to Commingle

1 The common law duty.

A 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 the trust and to see that the property is designated as property of the trust, Restatement (Second) of Trusts, *supra,* § 179; *Bogert, supra,* § 596-612; *Scott, supra,* § 179.

The genesis of the current Texas rule regarding tracing of commingled trust funds was the case of *Andrews v. Brown*, 10 S.W.2d 707 (Com. App. 1928) in which the Court observed:

> "If a man mixes trust funds with his own," it is said, "the whole will be

> treated as trust property, except so far as he may be able to distinguish what is his own." Vice Chancellor Sir W. Page Wood, in *Frith v. Cortland*, 2 Hem. & M. 417, 420. That principle seems to have recognition in most, if not all, American jurisdictions . . . [cites omitted, emphasis supplied]
>
> Analogous doctrines are part of the law of accession and specification . . . and of confusion of goods . . The principle, we apprehend, is but a part of equity's declination to extricate the wrongdoer from self-imposed hard conditions, or to tax the innocent, where one of two not in pari delicto must suffer. [cites omitted]

Id, at 709. This rule was first recognized by the Texas Supreme Court in *Logan v. Logan*, 156 S.W.2d 507 (Tex. 1941) in which the court stated:

> It is a general rule 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 cestui que trust; and if he cannot do so the whole commingled fund, or the property purchased therewith, becomes subject to a trust in favor of the cestui que trust. 42 Tex. Jur. 740; 65 C.J., 972,978; 11 Am. Jur., 529;12 C.J., 491; 15 C.J.S., Confusion of Goods, § 4j Bogert, Trust & Trustees, § 925, p.2677; *Andrews v. Brown* Tex. Com. App., 10 S.W.2d 707; *Meyers v. Baylor University*, Tex. Com App., 6 S.W.2d 393 writ refused. [emphasis supplied]

The rule is analogous to that of confusion of goods. *Andrews v. Brown*, supra. It is a harsh one, but is justified by the wrongful conduct of the trustee. The emphasis is on the injustice of requiring an innocent beneficiary to distinguish and trace the trust funds when the commingling was occasioned by the wrongful act of the trustee. It is expressed in *Andrews v. Brown*, supra [10 S.W.2d 709] as follows: "The principle, we apprehend, is but a part of equity's declination to extricate the

wrongdoer from self-imposed hard conditions, or to tax the innocent where one of the two not in pari delicto must suffer."

On the other hand, there are authorities which hold that if the commingling is done rightfully, and with the consent of the beneficiary, the basis for the rule is removed, and no presumption is raised that the entire fund, or property purchased therewith, is subject to the trust; and consequently the burden remains on the plaintiff to trace the trust funds into the specific property and to show the amount thereof as one of the essential elements of his case. [cites omitted]

Perhaps the rule last above announced should be qualified to the extent that where the proof necessary to distinguish the fund lies exclusively within the possession of the trustee and he refuses to make disclosure of such facts as he has at his command, the presumption should be indulged in favor of the cestui que trust.

This doctrine was reiterated by the Texas Supreme Court in *Eaton v. Hasted*, 172 S.W.2d 493 (Tex. 1943). In this case a trustee commingled the trust estate with his own funds. More than twenty-four years elapsed after he had disposed of the last known item of the trust estate. The trustee kept no books, left no evidence of what he owed the beneficiary. He, in truth, dealt with the trust estate as his own. In this situation the court observed:

> A great authority has written that "where there has been no positive loss, but the whole funds, principal, profits and proceeds, are in the trustee's hand in their mingled condition, the burden of proof rests upon him of showing most conclusively what portion is his, and whatever of the mixed fund, including both profits and principal, he cannot thus show to be his own, even though it be the whole mass, will be awarded to the beneficiary." Pomeroy, E.Q. Jur., Th Ed., vol.3, sec. 1076, p. 2471. Another writer has said that the trustee must not mingle the trust fund with his own; that, if he does, the beneficiary may follow the trust property, and claim every part of the blended property which the trustee

> cannot identify as his own; that if he fails to keep clear, distinct and accurate accounts, all presumptions are against him and all obscurities and doubts are to be taken adversely to him. Perry, Trusts and Trustees Th Ed., vol. 1, sec. 447, p. 717, vol. 2, sec. 821, P. 1351; ibid., Th edition, vol. 1, sec. 447, and vol. 2 sacs. 837, 838. In *Andrews v. Brown*, Tex. Com. App., 10 S.W.2d 707, it is held that if a trustee mixes trust funds with his own, the whole will be treated as trust property, except so far as he may be able to distinguish what is his own. [emphasis added]
>
> Since it is undisputed that George Eaton did have in his possession physical properties of the estate of Lou Eaton long after her death, which he liquidated and commingled with his own, it was the burden of petitioners, who stand in his shoes, to distinguish what belonged to him by reason of any expenditure on account of Lou Eaton; it was their obligation to plead and prove what belonged to them on that score. We think the justness of the rule placing this burden on petitioners is obvious. Mrs. Hasted was an infant when the trust was created and it was not until thirty years later that she learned there was any trust. Opposed by unfriendly claimants, the heirs of the dead trustee, who had accorded her no consideration even before there was any property dispute, she was in no position to know how the trust had been administered or to learn what had become of its properties. "Where facts lie peculiarly within the knowledge of a party and cannot, in the nature of the case, be known to his adversary, the party having knowledge has the burden of proving the facts." *Spencer v. Petit*, Tex. Civ. App., 17 S.W.2d 1102 @ 1106, (Affirmed, Tex. Com. App., 34 S.W.2d 798). [emphasis supplied]

Id at 497-498. Even though it was possible to prove that the trust funds had been commingled, it was not possible to trace trust funds into one particular tract of real property acquired by the

trustee after the commingling. In dealing with this property the *Eaton* Court stated:

> More difficulty attends the question as to whether trust funds were used to purchase the Est Tract, but we think the action of the courts below in fixing a trust on it may properly be grounded on the doctrine of commingling. The quotations which we have already made from Pomeroy and Perry support this view. Moreover, "As a general rule the cestui que trust's equitable right of recovery is not destroyed by reason of the fact that the trustee has so commingled the trust property with his own property that it is impossible particularly to be ascertained and separated from the rest, the entire commingled fund or property will be treated as subject to the trust . . . *except insofar as the trustee may be able to distinguish and separated that which is his own."* (Italics ours) 65 C.J., sec. 899, p.972. Otherwise, the law would be placing a premium rather than a penalty on the trustee's violation of his imperative duty to deep regular and accurate accounts during the whole course of the trust. Pomeroy, E.Q. Jur. Th Ed. vol.3, sec. 1063. [emphasis supplied]

Id, at 498-499 In so holding the Eaton Court observed that this case presented a much stronger case for identification and tracing of trust funds that was shown in Spencer et al v. Petit et al, 34 S.W.2d 798 (Tex. Com. App. 1931). In the Spencer case the trustee so mixed and mingled the proceeds of the original personal property on hand that it lost its identity. The record failed to in any manner account for what became of the assets. In fact the trustee himself testified that he was unable to tell what funds were used to purchase the tracts of land which he claimed to own or how he got the money to purchase them. The Eaton Court observed that in Spencer all assignments of error that there was no evidence that the funds of the children had been traced into the cash payments for the land were overruled.

Finally the Court in Eaton held that the heir, devisee or donee of a trustee, who commingles trust

funds with his own, stands in the shoes of the trustee with respect to the burden to trace commingled trust funds:

> It must be remembered that we have in this case no intervening rights of creditors of George Eaton, that we have no innocent purchaser whose rights or interests will be affected. The petitioners, claiming as heirs of the trustee, can assert no rights or equities which he could not assert were he the defendant. The principle applied may, in some respects, seem hard and not free from difficulty. Nevertheless, "the principle, we apprehend, is but a part of equity's declination to extricate the wrongdoer from self-imposed hard conditions, or to tax the innocent, where one or two not in pari delicto must suffer." *Andrews v. Brown*, supra.

Eaton, 172 S.W.2d at 499.

If, however, the beneficiary of the trust is seeking to recover trust property from:

a. a person who has paid the commingling trustee fair and adequate consideration for the property, or
b. a creditor of the commingling trustee who has advanced consideration to such trustee for the debt,

then Texas law would require strict tracing and other rules would apply.

These rules were again recognized by the Texas Supreme Court in the case of *Lung v. Lung*, 259 S.W.2d 253 (Tex.1953). After quoting extensively from the *Logan* case the Court held that:

> These profits were commingled with defendant's own funds and used by him in the purchase of properties in his own name. For these reasons we think it cannot be said the commingling was rightful, for which reasons the burden was on defendant to trace the funds. *Logan v. Logan*, supra; *Eaton v. Hasted*, 141 Tex. 349, 172 S.W.2d 493. [emphasis supplied]

Id. at 259. See also *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.), in which the court stated:

> Plaintiffs concede in their brief that "second Tithe" funds were subject to a trust. While there is evidence that the assets and properties here involved were purchased with commingled "First" and "Second" Tithe funds, the cestui's right of recovery is not destroyed by reason of the fact the Trustee commingled the trust property with its own property. The entire commingled fund or property will be treated as subject to the trust . . . And if the Trustee invests the trust fund or its proceeds in other property, the cestui que trust may follow the fund into the new investment . . . And where the Trustee mingles the trust money with his own, whenever he pays out he is presumed to have paid out with his own money. [cites omitted]

Id. at 259. These rules were applied by the Amarillo Court of Civil Appeals in 1979 in the case of *Peirce v. Sheldon Petroleum Co.*, 589 S.W.2d 849 (Tex.Civ.App.--Amarillo 1979, no writ). The Court stated:

> When, however, tracing to specific property is impossible because the trustee has commingled the property, the right is not defeated if the beneficiary can trace to the commingled fund. *Logan v. Logan*, 138 Tex. 40, 156 S.W.2d 507 (1941). If the commingling was wrongful, the burden is on the trustee to establish which property is rightfully the trustee's. If the trustee is unable to do so, the entire commingled property is subject to the trust. [emphasis supplied]

Id., at 853.

2 The statutory duty of a trustee.

There is no statutory duty to segregate that specifically applies to trustees.

H0 Duty to Carry Out the Directions of the Person Creating the Fiduciary Relationship

1 The common law duty.

The Restatement (Second) of Trusts, *supra,* § 169 provides:

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

See also *Scott, supra,* § 169; *Bogert,* supra, § 583. This duty includes a duty to strictly adhere to the terms and provisions of the instrument creating the fiduciary relationship.

2 The statutory duty of a trustee.

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."

I0 Duty to Keep the Beneficiaries Informed and to Account to Them

1 The common law duty.

A trustee has a duty to inform the beneficiary of important matters concerning the trust and the beneficiary is entitled to demand of the fiduciary information about the trust. See *InterFirst Bank Dallas, N.A. v. Risser*, supra. It follows that a fiduciary 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 compel an accounting from the fiduciary. The duty to keep the beneficiaries informed about non-routine transactions of a substantial nature can be a considered separate and distinct duty from the duty to account to them. This duty exists independently of the rules of discovery, applying even if no litigious dispute exists between the trustee and the beneficiaries. *Huie v. DeShazo*, 922 S.W.2d 920; Opinion No. 95-0873 (Tex. 1996); *Montgomery v. Kennedy,* 669 S.W.2d 309 (Tex. 1984); *Bogert, supra*, §§ 961-974;

Scott, supra, §§ 172-173; Restatement (Second) of Trusts, *supra,* §§ 172-173.

2 The statutory duty of a trustee.

A trustee may be compelled by a beneficiary to furnish an accounting, Texas Trust Code § 113.151, absent such a demand a trustee has no statutory obligation to furnish beneficiaries with periodic accountings unless the instrument creating the fiduciary relationship mandates periodic accountings.

J0 Duty to Preserve and Protect the Trust Property

1 The common law duty.

A trustee is under the duty to use reasonable care and skill to preserve the trust property. Restatement (Second) of Trusts, *supra,* § 176; *Bogert, supra* § 582; *Scott, supra,* § 176.

2 The statutory duty of a trustee.

There is no statutory duty of preservation that specifically applies to trustees.

K0 Duty Not to Delegate Trust Responsibilities

1 The common law duty.

A trustee is under a duty not to delegate to others the doing of acts which the fiduciary can reasonably be required personally to perform. Restatement (Second) of Trusts, *supra,* §§ 171, 184; *Scott, supra,* §§ 171, 184; *Bogert, supra,* §§ 584-591. Included in this duty is the duty not to abdicate or delegate administration to a co-trustee 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.

2 The statutory duty of a trustee.

There is no statutory duty not to delegate that specifically applies to a co-trustee. The Texas Trust Code, however, specifically allows a trustor to delegate trust powers and duties among

collective co-trustees. Tex. Trust Code Ann. § 114.003 (Vernon 1984).

L0 Duty to Keep Accurate Books and Records

1 The common law duty.

A trustee is under a duty to keep accurate books and records regarding what constitutes the trust receipts and disbursements to and from the trust estate, all receipts and disbursements to and from the trust estate and, where applicable, records of all allocations of receipts and disbursements between the principal account and the income account. In addition to accounting records, a fiduciary has a duty to keep accurate legal and business records regarding the trust estate. *Shannon v. Frost National Bank*, 533 S.W.2d 389 (Tex.Civ.App.-San Antonio 1975, writ ref'd n.r.e.); See *Bogert, supra,* § 962.

2 The statutory duty of a trustee.

There is no statutory duty that specifically requires a trustee to keep accurate books and records.

M0 Duty to Make the Trust Property Productive

1 The common law duty.
A trustee is under a duty to use reasonable care and skill to make the trust property productive. 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. Restatement (Second) of Trusts, *supra,* § 181; *Bogert*, *supra,* § 611; *Scott, supra,* § 181. See also *Langford v. Shamburger*, 417 S.W.2d 438, 444-445 (Tex. Civ. App. -- Fort Worth 1967, writ ref'd n.r.e.).

2 The statutory duty of a trustee.

1. Texas Trust Code § 113.110 provides:

i. Except as provided by Subsection (b) of this section, if part of the principal consists of any type of property that has been under-productive for more than one year

and if the trustee is required to sell or otherwise dispose of the property, the trustee shall do so as soon as possible, and if the sale or other disposition is made before the principal is finally distributed, to the extent that the net proceeds from the sale exceed the inventory value of the property, the income beneficiary or the beneficiary's estate is entitled to a share of the net proceeds. The beneficiary's share is an amount equal to:

(a) the difference between the net proceeds and the amount which, if invested at four percent a year simple interest during the allocation period, would have produced the net proceeds, less

(b) the income received by the income beneficiary from the trust property or the value of the income beneficiary's use of the trust property during the allocation period.

ii. Property is under productive if it does not produce an average annual net income, without considering depreciation or obsolescence, equal to at least one percent of its value.

iii. The allocation period begins one year after the property becomes under productive or one year after the trustee receives the property if it was under productive at the time of receipt.

iv. If there are successive income beneficiaries, the income beneficiaries' share of the net proceeds shall be divided among them according to the time each was entitled to income.

v. This section does not require a trustee to sell or dispose of property. The determination as to

whether the trustee is required to sell or dispose of property shall be made in accordance with the requirements set out in the governing instructions, other provisions of this code, and the common law.

vi. For the purposes of this section:

(a) The "value" of property is:

(1) inventory value;
(2) if the property is part of the original principal and does not have an inventory value, market value;
(3) if the property is purchased after the principal is established and does not have an inventory value, its cost; or
(4) if the property is acquired through foreclosure of a mortgage held by the trust, the net investment in the property up to the date of resale by the trust, and not the bid price at the foreclosure sale.

(b) "Net proceeds" is gross proceeds received for the property less the sum of the expenses incurred in disposing of it and all carrying charges that were charged to principal while it was under productive.

(c) "Net investment" is all money invested and advanced. Tex. Trust Code Ann. § 113.110 (Vernon Supp. 1991).

See also Texas Trust Code § 114.001(b) which 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 Section 113.056 [the prudent man rule] or from any other breach of trust. (emphasis supplied) Tex. Trust Code Ann. § 114.001(b) (Vernon Supp. 1991).

N0 Duty to Review Trust Investments Periodically

1 The common law duty.

A trustee has the duty of examining and checking the trust investments periodically through the life 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.

2 The statutory duty of a trustee.

Texas Trust Code § 113.056(c) provides:

> Within the limitations of Subsection (a) of this section, a trustee may indefinitely retain property acquired under this section without regard to its suitability for original purchase. Tex. Trust Code Ann. § 113.056(c) (Vernon Supp. 1991)

O0 Duty to Uphold and Defend the Trust

1 The common law duty.

A trustee has a duty to actively defend any attack on the validity of the trust or any of its provisions. See *Bogert, supra,* § 581; *Scott, supra,* § 178; Restatement (Second) of Trusts, *supra,* § 178. 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.

2 The statutory duty of a trustee.

There is no statutory duty to uphold and defend the trust that applies specifically to trustees. See *Id.*

P0 Duty to Pay the Income Beneficiary

1 The common law duty.

Where a trustee is directed by the trust instrument to pay income to a beneficiary for a designated period, the trustee is under a duty to pay to him at reasonable intervals the net income from the trust property. See Restatement (Second) of Trusts, *supra,* § 182; *Scott, supra,* § 182.

2 The statutory duty of a trustee.

There is no statutory duty to pay income to the income beneficiary that applies specifically to trustees.

IV EXERCISE OF 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.

A. Support Trust If a trust is a support trust then the beneficiary may compel the trustee to make distribution in accordance with a specific distribution standard. The distribution standard of a support trust is generally referred to as 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.

Support trusts also often have language requiring the trustee to consider other sources of "income," "resources," "assets" available to the beneficiary at the time of distribution.

Support trusts also often have language requiring distribution according to a certain "standard of living" that the beneficiary enjoys at a prescribed period of time.

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. *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.__). He may not act arbitrarily in the matter, however pure his motives. *In Re Browns Appeal*, 345 Pa. 373, 29 A.2d 52; *Restatements 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.

B. Discretionary Trusts 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. If a trust is a discretionary trust then the beneficiary may not compel the trustee to make distribution. Distributions from a discretionary trust are in the sole discretion of the trustee and are not subject to any specific distribution standard. The distribution standard of a discretionary trust is generally referred to as a nonobjective standard. The standard is nonobjective because it is not specific

enough to be objectively applied. The distribution standard in a typical discretionary trust permits distribution "in the sole discretion of the trustee."

A description of discretionary trusts is contained in Section 228 of *Bogert ,supra*, 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.

C. 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); *Brown v. Scherck*, 393 S.W.2d 172 (Tex. Civ. App.-Corpus Christi, 1965) and *Nations v. Ulmer,* 122 S.W.2d 700 (Tex. Civ. App.-El Paso, 1938).

An abuse of discretion does not usually occur unless the trustee acts outside the bounds of "reasonable judgment." *Scott, supra,* § 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.

Use of the terms "absolute," "uncontrolled," "sole" and "exclusive" in granting discretion to a trustee does not completely absolve the fiduciary from acting reasonably. *First Nat'l. Bank v. Howard*, 149 Tex. 130, 229 S.W.2d 781 (Tex. 1950); *Thorman v. Carr*, 412 S.W.2d 45 (Tex.1967)

D. 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, supra,* § 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, supra,.*

V MODIFICATION, LIMITATION AND RELEASE OF FIDUCIARY DUTIES

A0 Generally

1 By the Court

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 delete any fiduciary duty (regardless of whether or not the duty is a statutory fiduciary duty or a common law fiduciary duty).

2. By The Settlor.

Some Fiduciary duties can be modified or completely eliminated by the Settlor, others can not. The Texas Trust Code provides that statutory duties may be waived or modified. This does not necessarily mean that the common law fiduciary duties may be waived or modified.

The interrelation between fiduciary duties imposed by the common law and fiduciary duties imposed by the Trust Code is complex. While statutory duties contained in the Texas Trust Code impose strict liability and can be waived, the broad common law fiduciary duty of loyalty can not be waived. 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).

No reported Texas case has held that the fiduciary duty of loyalty can be completely waived. To do so would completely destroy the fiduciary relationship and give the trustee a general power of appointment over the trust estate of the trust. This would allow the trustee to consume the trust estate for his personal benefit and would force inclusion of the trust estate in the trustee's federal estate tax base.

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.

2. Modification or Waiver of Statutory Duties

1. Texas Trust Code Ann. §113.059 provides that:

1. Except as provided by Subsection (b) of 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.

2. A settlor may not relieve a corporate trustee from the duties, restrictions, or liabilities of Section 113.052 or 113.053 of this subtitle.

C. Modification or Waiver Of Common Law Duties

The waiver or modification of the common law fiduciary duties is 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 waiver

and/or modification of fiduciary duties has not been fully reconciled. This is especially confusing because of the overlap between many of the common law and statutory fiduciary duties[1].

2. Modification, Limitation or Release of Specific Fiduciary Duties:

1. Loyalty/Self Dealing

1. A trustee is prohibited from self-dealing by statute and by common law:

The starting point for any analysis of the duty not to engage in self-dealing and its possible waiver must begin with the general, fundamental duty of loyalty and the historical and unbending reluctance of courts to undermine the powerful policies that undergird it.

b. The General Rule
Texas courts (indeed, most American courts) hold trustees to a "very high and very strict standard of conduct which equity demands." *Slay v. Burnett Trust,* 143 Tex. 621, 187 S. W.

[1] For example, both common law and statutory fiduciary duties prevent a trustee from purchasing property from the trust estate of the trust that the trustee is administering. If this statutory fiduciary duty is expressly waived by the trust instrument, how is the common law duty affected?

2d 377, 387 (1945). At the core of this high standard for judging fiduciary behavior are the duty of loyalty and duty not to self-deal. A trustee is prohibited from even placing himself in a position where the trustee may be tempted to take advantage of the beneficiary. Bogert, *Trusts and Trustees* (Second Edition Revised) (1993), §543.

It is essential to remember that the duty of loyalty imposes a **duty** not to self-deal.

All prohibitions on self-dealing flow from the duty of loyalty. Bogert explains the rationale for this approach as follows:

> Reasons behind the establishment of the loyalty rule by equity are that it is generally, if not always, humanly impossible for the same person to act fairly in two capacities and on behalf of two interests in the same transaction. ...
>
> The public policy reasons underlying the duty of loyalty are several. **A trustee is expected to act on behalf of the beneficiary with an independent and disinterested judgment. If his individual interest is injected into trust matters he cannot remain independent or disinterested.** It is not possible for any person to act fairly in the same transaction on behalf of himself and in the interest of the trust beneficiary. **It is only human that he will tend to favor his individual interest, whether consciously or unconsciously, over that of the beneficiary.** Furthermore, **the confidential nature of the trust relationship lends itself to secrecy and concealment on the part of a trustee who may be tempted to exploit the trust**. In addition, even though the trustee may render accounts to the beneficiary or to the court, the beneficiary's chance of discovering the disloyal act is

> remote; thus, as a practical matter, the beneficiary may have no opportunity to object or to obtain relief.
>
> Whether the action of the trustee who attempted to represent himself or a third person on the one hand, and the trust beneficiaries on the other, was fair to the beneficiaries in any given case is often difficult of proof. **A shrewd trustee may be able to conceal special advantages to himself or disadvantages to the beneficiaries.** In many cases the self-dealing of the trustee may be kept secret until it is too late for the beneficiaries to object and obtain relief.
>
> In its wish to guard the highly valuable fiduciary relationships against improper administration, **equity deems it better to forbid disloyalty and strike down all disloyal acts, rather than to attempt to separate the harmless and the harmful by permitting the trustee to justify his representation of two interests.**

Bogert, *Trusts and Trustees* (Second Edition Revised) (1993), §543 (emphasis added).

c. Texas Follows the General Rule

In *Johnson v. Peckham*, 132 Tex. 148, 120 S. W. 2d 786 (Tex. 1938), the Supreme Court pronounced the rule governing fiduciary relationships in this State:

> **When persons enter into fiduciary relations each consents, as a matter of law, to have his conduct towards the other measured by the standards of the finer loyalties exacted by courts of equity. That is a sound rule and should not be whittled down by exceptions.** (emphasis supplied)

This rule was followed in *Slay v. Burnett Trust,* 143 Tex. 621, 187 S. W. 2d 377, 387 (1945) which held that:

> The rule is general in its use and is fundamental. It is for the benefit of the cestui que trust and undertakes to enforce the duty of loyalty on the part of the trustee by prohibiting him from using the advantage of his position to gain any benefit for himself at the expense of his cestui que trust and from placing himself in any position where his self interest will or may conflict with his obligations as trustee.

If a trustee engages in a self dealing activity without specific authorization in the trust instrument, he breaches his duty of loyalty, and the "no further inquiry" rule imposes strict liability on the trustee. As explained by Dukeminier and Johanson in *Wills, Trusts and Estates*, 5th Edition (1995), at page 907:

> If the trustee engages in self-dealing, good faith and fairness to the beneficiaries are not enough to save the trustee from liability. In case of self-dealing, *no further*

> *inquiry* is made; the trustee's good faith and the reasonableness of the transaction are irrelevant. [Italics in original; bold-face emphasis added.]

In addition to the statutory duty of loyalty not to engage in certain self-dealing transactions, the trustee of a Texas trust is subject to a common law duty not to self-deal. The statutory prohibitions of self-dealing supplement rather than replace the common law duties. *See* Tex. Trust Code §113.051. As one commentator noted:

> In dealing with trust property, the trustee must set aside its own interests and opportunities for gain. Both Texas law and the general common law impose on the trustee an absolute duty of good faith, fair dealing, loyalty, and fidelity with respect to the trust, its property, and its beneficiaries. Consequently, the trustee is generally prohibited from buying trust property, selling property to the trust, or engaging in any other type of self-dealing. Most common law and statutory prohibitions against self-dealing originate as a result of the trustee's fundamental duty of loyalty to the trust and its beneficiaries.

McLaughlin, *Texas Probate, Estate, and Trust Administration,* §81.23[1] (1996).
There are three elements of the common law duty not to engage in self-dealing: (1) A trustee must always place the best interests of the beneficiaries ahead of his personal self-interest. *Crenshaw v. Swenson,* 611 S. W. 2d 886, 890 (Tex. Civ. App. -- Austin 1980, writ ref'd n. r. e.); (2) Any transaction between a trustee (or related party) and the trust must be fair to the beneficiaries. Dukeminier and Johanson, *Wills, Trusts and Estates*, 5th Edition (1995), p. 907; and (3) A

trustee may not make a profit from his office as trustee:

> It is a well-settled rule that a trustee can make no profit out of his trust. The rule in such cases springs from his duty to protect the interests of the estate, and not to permit his personal interest to in any wise conflict with his duty in that respect. The intention is to provide against any possible selfish interest exercising an influence which can interfere with the faithful discharge of the duty which is owing in a fiduciary capacity.

Slay v. Burnett Trust, 143 Tex. 621, 187 S. W. 2d 377, 388 (1945), (quoting *Magruder v. Drury,* 235 U. S. 106, 35 S. Ct. 77, 59 L. Ed. 151).

Enactment of the Texas Trust Code in 1983 did not eliminate these common law concepts; rather, it embraced them, recognized them, and in some cases codified them. For example, the Commentary on the Texas Trust Code issued upon its enactment states:

> Section 114.001(a) codifies a well-established principle of trust law followed in the Texas cases. *See Slay v. Burnett Trust,* 143 Tex. 621, 187 S. W. 2d 377 (1945); *Crenshaw v. Swenson,* 611 S. W. 2d 886, 890 (Tex.

Civ. App. -- Austin 1980, writ ref'd, n. r. e.); *Hamman v. Ritchie,* 547 S. W. 2d 698, 710 (Tex. Civ. App. -- Fort Worth 1977, writ ref'd, n. r. e.).

State Bar of Texas Real Estate, Probate and Trust Law Section, *Guide to the Texas Trust Code* (1984), p. 19. Thus, the pronouncements of Texas trust law in pre-Trust Code cases such as *Slay v. Burnett Trust* are still valid, and Plaintiff is entitled to the protection they afford.

d. Waiver or Modification of the Statutory Duty Not to Self-Deal

i. A Waiver of The Duty Must Be Express

Texas courts apply a rule of strict construction in determining whether a provision of the Trust Code has been waived: "**When a derogation of the Act hangs in the balance, a trust instrument should be strictly construed in favor of the beneficiaries.**" *Price v. Johnston,* 638 S. W. 2d 1, 4 (Tex. App. -- Corpus Christi 1982, no writ) [emphasis added].

In construing purported waiver language, it is essential to keep in mind the distinction between powers and duties drawn by the structure of the Trust Code (Subchapter A is "powers" and Subchapter B is "Duties") and the distinction between "duty," "liability," or "restriction" drawn in section 113.059. When the Trust Code or Act refers to a **duty**, it expressly uses that word. Likewise, it expressly distinguishes between a "duty" and powers, liabilities, and restrictions.

Accordingly, broad grants of **power** do not waive the **duty** not to self-deal:

> **The Texas courts have never interpreted liberally the broad powers of management as a justification for lessening the high standards to which fiduciaries are held under the Texas Trust Act.** *See Slay v. Burnett Trust,* 143 Tex. 621, 187 S. W. 2d 377 (1945).... Since the will does not specifically permit the sale to a "relative", the Texas Trust Act must apply, which prohibits the intended sale.

Price v. Johnston, 638 S. W. 2d 1, 4 (Tex. App. -- Corpus Christi 1982, no writ) [emphasis added]. McLaughlin, *Texas Probate, Estate, and Trust Administration,* §81.25[1] (1996) ("The trustee's broad powers of management have never been interpreted as a justification for lessening the high standards to which fiduciaries are held, and trust instruments are strictly construed in favor of the beneficiary.")

In fact, no reported Texas case holds that a broad general grant of powers in an **unambiguous** trust instrument waives the duty not to self-deal. Rather, the cases consistently follow the rationale expressed in *Price v. Johnson*. In *Furr v. Hall,* the Court studied the broad powers in the trust instrument and concluded:

> [T]he language of the will itself does not go so far as to negate the restrictions of Section 12 of the Texas Trust Act by specifically authorizing the trustees to purchase for themselves, either directly or indirectly, any properties from the trust. **The expression that the powers of management were to be exercised as if the trustees were the owner in fee simple amounts to no more than a direction that the powers actually granted were to be unfettered**.

Furr v. Hall, 553 S. W. 2d 666, 672 (Tex. App. -- Amarillo 1977, writ ref'd, n. r. e.) [emphasis added]. The *Furr* court further analogized the self-dealing rules in the Act to the prohibitions of the common law duty of loyalty:

An analogy may be drawn from the situation arising in *Slay v. Burnett Trust*, 143 S. W. 2d 377 (Tex. 1945), before the enactment of the Texas Trust Act. There, the grant to the trustees of broad powers of management similar to those in the case at bar did not justify some of the trustee's profitable self-dealing in the trust's properties, the Supreme Court saying that a trustee is prohibited from placing himself in any position where his self interest will or may conflict with his obligations as trustee, even though he may have acted in good faith and the beneficiary suffered no damage.

The distinction between powers and duties is not only fundamental to trust law; it makes perfect sense. A trustee can have the power to engage in a certain type

of transaction -- such as making speculative investments -- but he must still do so for the exclusive benefit of the beneficiaries. In light of the jaundiced eye trust law casts on self-dealing, permission to make loans simply cannot be construed as permission to make loans to **oneself.**

Most trusts grant the trustee very broad powers to manage and control the trust estate of the trust. There is sound public policy for the precedent that expansive trust powers alone do not modify or eliminate a trustees fiduciary duties to the beneficiaries of the trust. This is especially true with respect to the fiduciary duty of loyalty. To the extent that the self dealing provisions of the Texas Trust Code can be waived by the trustor, Texas Courts have, as noted above, required explicit waiver of these provisions.

In light of these principles, to be effective, any waiver in a trust instrument of the statutory **duty** not to self-deal must be a clear, specific, and unequivocal waiver of a "duty." It must also make clear that what is being permitted is a self-dealing transaction. **For example, the trust instrument must either (1) expressly authorize the activity (by saying, for example, "My trustee is expressly authorized to purchase assets from the trust estate for his personal benefit") or (2) expressly waive the statutory self-dealing duties (by saying, for example, "The duties imposed by Section 113.053 of the Texas Trust Code are hereby waived.")**

ii. The Jochec Case.

Jochec v. Clayburne, 863 S. W. 2d 516 (Tex. App. -- Austin 1993, writ denied), is sometimes cited for the proposition that the conduct of the parties overrides the rule of strict construction in favor of the beneficiary. It is also sometimes cited for the proposition that a general grant of power to a trustee can waive the statutory prohibitions against self dealing.

The *Jochec* opinion is based on the interesting but erroneous proposition that a trustee's disclosure to the **settlor** can somehow constitute a waiver of statutory

fiduciary prohibitions against self dealing. This principal conflicts with centuries of trust law that provides that a trustee owes the settlor no duty of disclosure. A trustee's duty of disclosure is to the beneficiaries of the trust rather than to the settlor.

It is the author's contention that *Jochec* does not change the well-established trust principles relating to construction and waiver for several reasons.

Jochec is an aberration. Dozens of trust cases and decades of Texas jurisprudence support the strict construction rule and the other trust principles cited in this paper. *See, e.g., Slay v. Burnett Trust,* 143 Tex. 621, 187 S. W. 2d 377, 387 (1945); *Johnson v. Peckham*, 132 Tex. 148, 120 S. W. 2d 786 (Tex. 1938); *InterFirst Bank Dallas, N. A. v. Risser,* 739 S. W. 2d 882 (Tex. App. -- Texarkana 1987, no writ); *Price v. Johnston,* 638 S. W. 2d 1, 4 (Tex. App. -- Corpus Christi 1982, no writ); *Crenshaw v. Swenson,* 611 S. W. 2d 886, 890 (Tex. Civ. App. -- Austin 1980, writ ref'd n. r. e.); *Furr v. Hall,* 553 S. W. 2d 666, 672 (Tex. App. -- Amarillo 1977, writ ref'd, n. r. e.); *Langford v. Shamburger,* 417 S. W. 2d 438, 443-4 (Tex. Civ. App. -- Fort Worth 1967, writ ref'd, n. r. e.). In addition, virtually all of the commentators and other secondary authority support the author's position. In contrast, *Jochec* has not been cited by *any* Texas appellate court.

In *Jochec,* the actions and conduct of the parties which the court considered relevant were acts relating to *disclosure of the relevant facts regarding the self-dealing transaction*. The court cited evidence that the trustee kept the settlor informed, so presumably the settlor intended for the trustee's duty of fidelity to be modified. 863 S. W. 2d at 519-520.

The court found the *Jochec* trust instrument to be ambiguous.

Despite the court's rhetoric about modification of the duty not to self-deal in *Jochec*, in fact the duty not to self-deal was not modified in *Jochec. See* 863 S. W. 2d at 520-1, footnote 2 ("The Jochecs [defendants] do not dispute the accuracy of this definition [of self-dealing]

and concede that 'the jury was properly instructed that Jan Jochec [trustee] had a duty not to self-deal.'").

e. The Common Law Prohibition Against Self-Dealing Cannot Be Waived

The common law duty of loyalty cannot be waived by the trust instrument. Any attempted waiver is against public policy. *InterFirst Bank Dallas, N. A. v. Risser,* 739 S. W. 2d 882, 888 (Tex. App. -- Texarkana 1987, no writ); *Langford v. Shamburger,* 417 S. W. 2d 438, 444 (Tex. Civ. App. -- Fort Worth 1967, writ ref'd, n. r. e.).

As the *Risser* court explained:

> Historically, one of the reasons to separate self dealing (in a 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 that 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.

An agreement by a fiduciary to exclude all fiduciary responsibility is against public policy." *Maykus v. First City Realty and Financial Corporation,* 518 S. W. 2d 887, 893 (Tex. App. -- Dallas, 1974, no writ).

The *Risser* court also held that:

> 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 trustee for another. The rule if 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 S. W. 595 (1904). A trustee may not use his position to obtain any advantage that is inconsistent with is primary duty to the beneficiaries. *MacDonald v. Follett,* 142 Tex. 616, 180 S. W. 2d 334 (1944).
>
> 739 S. W. 2d at 898-899.

In *Girder v. Boston Co. Inc.,* 773 S. W. 2d 338, 343 (Tex. App. -- Dallas 1989, writ denied), the Dallas Court of Appeals has followed *Risser* in holding that:

> When the parties bargain on equal terms, 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. *Id.* at 897-898. *See also* TEX. PROP. CODE ANN. § 113.059 (Vernon 1984)(repealing former TEX. REV. C.V. STAT. ANN. art. 7425b-22).

1. Good Faith and Fair Play

   (a) WAIVER OR MODIFICATION OF THE STATUTORY DUTY.

   (b) WAIVER OR MODIFICATION OF THE COMMON LAW DUTY.

ii. Take Possession of Trust Property

   (a) WAIVER OR MODIFICATION OF THE STATUTORY DUTY.

   (b) WAIVER OR MODIFICATION OF THE COMMON LAW DUTY.

iii. Not to Commingle

(a) WAIVER OR MODIFICATION OF THE STATUTORY DUTY.

(b) WAIVER OR MODIFICATION OF THE COMMON LAW DUTY.

iv. Carry Out The Intent of The Trustor

(a) WAIVER OR MODIFICATION OF THE STATUTORY DUTY.

(b) WAIVER OR MODIFICATION OF THE COMMON LAW DUTY.

22. Duty To Account To The Trust Beneficiaries

(a) WAIVER OR MODIFICATION OF THE STATUTORY DUTY.

Notwithstanding the Texas Trust Code Ann. §113.059 (relating to the power of a trustor to alter the trustee's responsibilities), it is the author's opinion that the accounting requirements set forth in Texas Trust Code Ann. §113.151 & §113.152 may not be waived by the trustor of a trust. To do so would fundamentally interfere with the essence of the trust relationship.

(b) WAIVER OR MODIFICATION OF THE COMMON LAW DUTY

A Settlor may not totally eliminate the trustee's duty to provide an accounting to the court. *Hollenbeck v. Hanna,* 802 S.W.2d 412 (Tex. App.--San Antonio, 1991). *Hollenbeck* contained dicta wherein the court also questioned whether a settlor should be able to deprive any significant beneficiary of the statutory right to seek an accounting.

vi. Duty To Preserve And Protect The Trust Property

(a) WAIVER OR MODIFICATION OF THE STATUTORY DUTY.

(b) WAIVER OR MODIFICATION OF THE COMMON LAW DUTY.

vii. Duty Not To Delegate

(a) WAIVER OR MODIFICATION OF THE STATUTORY DUTY.

(b) WAIVER OR MODIFICATION OF THE COMMON LAW DUTY.

viii. Duty To Keep Accurate Books and Records

(a) WAIVER OR MODIFICATION OF THE STATUTORY DUTY.

(b) WAIVER OR MODIFICATION OF THE COMMON LAW DUTY.

ix. Duty To Make Trust Property Productive

(a) WAIVER OR MODIFICATION OF THE STATUTORY DUTY.

(b) WAIVER OR MODIFICATION OF THE COMMON LAW DUTY.

24. Duty To Review Trust Investments

(a) WAIVER OR MODIFICATION OF THE STATUTORY DUTY.

(b) WAIVER OR MODIFICATION OF THE COMMON LAW DUTY.

xi. Duty To Uphold and Defend The Trust

(a) WAIVER OR MODIFICATION OF THE STATUTORY DUTY.

(b) WAIVER OR MODIFICATION OF THE COMMON LAW DUTY.

xii. Duty To Pay The Income Beneficiary

(a) WAIVER OR MODIFICATION OF THE STATUTORY DUTY.

(b) WAIVER OR MODIFICATION OF THE COMMON LAW DUTY.

E. Exculpation

1. Trustees.

Texas Trust Code § 113.059 provides:

> 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.
>
> A settlor may not relieve a corporate trustee from the duties, restrictions, or liabilities of section 113.052 or 113.053 of this Act. Tex. Trust Code Ann. § 113.059 (Vernon 1984).

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.*

3. 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.

4. 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.

5. 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).

6. The *Restatement of Trusts 2d* has recognized additional 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.

7. 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.

8. 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.....

F. Court Authorization

1. Trustees.

Section 112.054 of the Trust Code provides:

> On the petition of a trustee or a beneficiary, a court may order that the trustee be changed, that the terms of the 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 . . . (emphasis supplied) Tex. Trust Code Ann. § 112.054 (Vernon Supp. 1991).

While time consuming and expensive, this provision allows extra protection for a trustee who seeks permission of the court to engage in action not authorized by the trust instrument. For the corporate fiduciary, it provides the only way to purchase or sell trust assets or to

borrow trust funds without incurring liability. In addition, it allows a fiduciary to do prohibited actions when releases or indemnification by beneficiaries would be potentially ineffective due to incapacity. Note that Trust Code Section 115.014 provides for the appointment of an attorney or guardian ad litem for unrepresented parties.

G. Actions of Beneficiaries

1. Consent.

a. Trustees.

ii. Texas Trust Code § 114.005 provides:

(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. (emphasis supplied)

(b) The release must be in writing and delivered to the trustee. Tex. Trust Code Ann. § 114.005 (Vernon 1984).

"Full information" is defined as full knowledge of all material facts which the trustee himself knows. *Slay v. Burnett Trust*, 187 S.W.2d 377 (Tex. 1945).

2. Estoppel.

There are cases in which a beneficiary has been held estopped from asserting a claim against a trustee because of the beneficiary's actual or presumed consent to the fiduciary's actions. *Beaty v. Bales*, 677 S.W.2d 750 (Tex.App.--San Antonio 1984, writ ref'd n.r.e.); *Langford v. Shamburger*, 417 S.W.2d 438 (Tex. Civ. App.--Fort Worth 1967, writ ref'd n.r.e.). However, the general rule is that the beneficiary has to have been fully and fairly informed of the actions constituting the breach of trust. In the case of self-dealing, the trustee has to have "affirmatively made a full and complete disclosure" to the beneficiary before estoppel will protect the fiduciary. *Burnett v. First Nat. Bank of Waco, Texas*, 536 S.W.2d 600 (Tex. Civ. App. --Eastland 1976, writ ref'd n.r.e.).

2. Releases and Indemnification

Releases and indemnifications present problems in the fiduciary context. First, releases must be supported by consideration. *Southwestern Fire and Cas. Co. v. Atkins*, 346 S.W.2d 892 (Tex. Civ. App.--Houston 1961, no writ). Consideration in a fiduciary context would have to involve the trustee performing or not performing some act which it would otherwise not do or do. For example, a trustee might agree to resign or to terminate the trust. The problem arises when a trustee agrees to do something he would otherwise be required to do in carrying out his fiduciary duties.

If there are unknown, contingent or minor beneficiaries, a trustee needs to obtain indemnification from primary beneficiaries in order to be fully protected. The indemnification must explicitly state that the indemnitor is indemnifying the trustee for acts of negligence in order for the contract to be enforceable in situations involving negligence. *Jewett v. Capital Nat. Bank of Austin*, 618 S.W.2d 109 (Tex. Civ. App.--Waco 1981, writ ref'd n.r.e.).

PART TWO - ACTIONS FOR BREACH OF FIDUCIARY DUTIES

I. TYPES OF ACTIONS INVOLVING BREACH OF FIDUCIARY DUTIES

A. Accounting

1. Texas Trust Code §114.001 provides that "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."

Tex. Trust Code Ann. §113.151 (a) provides that a beneficiary by written demand 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. The trustee is not required to account to beneficiaries more frequently than once every 12 months unless a more frequent accounting is required by the court.

2. Tex. Trust Code Ann. §113.151 (b) provides that an "interested person" [as such person is defined in Tex. Trust Code Ann. §111.004 (7)] may file suit to compel the trustee to account. Tex. Trust Code Ann. §113.151 also provides that a beneficiary may file suit to compel an accounting. A Settlor may not totally eliminate a trustee's duty to provide an accounting to the court. *Hollenbeck v. Hanna,* 802 S.W.2d 412 (Tex. App.-San Antonio, 1991)

3. Tex. Trust Code Ann. §113.152 outlines the contents of a trust Accounting. This section provides that a trust accounting shall show:

   a. 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;
   b. 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;
   c. a listing of all property being administered with an adequate description of each asset;
   d. the cash balance on hand and the name and location of the depository where the balance is kept; and
   e. all known liabilities owed by the trust.

4. An accounting demand is often the first step in litigation against the trustee. In addition to the accounting, a beneficiary is also entitled to inspect the books and records of the trustee. This informal discovery is often invaluable to a beneficiary seeking information about his or her trust.

B. <u>Breach of Fiduciary Duty</u>

1. Texas Courts recognize that courts may grant relief in an equitable proceeding for breach of fiduciary duty. *Risser, supra.*

2. 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

3. In *Branult v. Bigham, supra* 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.

C. Declaratory Judgment

1. Chapter 37 of the Texas Civ. Practice and Remedies Code § 37.005 provides that:

> 1. 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. . .
>
> i. to ascertain any class of creditors, devisees, legatees, heirs, next of kin or others;
> ii. to direct the . . . trustees to do or abstain from doing any particular act in their fiduciary capacity; or
> iii. to determine any question arising in the administration of the trust . . . including the construction of . . . other writings.

2. Chapter 37 of the Texas Civ. Practice and Remedies Code contains special provisions relating to parties, jury trials, costs and attorneys fees.

3. 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)

4. 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.

D. Petition for Instruction Under the Texas Trust Code

1. A cause of action may be brought to seek instruction from the court regarding what fiduciary duties exist, whether they may be dispensed with, or whether a fiduciary duty has been breached. The court would have jurisdiction to determine such action pursuant to Tex. Trust Code Ann. § 115.001 (see jurisdiction below)

2. 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, rearh'g denied) and *Gamel v. Smith,* 21 S.W. 628 (Tex. Civ. App.-1893)

3. Mandatory venue for this type of action is set forth in Tex. Trust Code Ann. §115.002 this is different from the venue provisions in the Texas Civ. Practice and Remedies Code which govern declaratory judgments.

5. Equitable Supervision Of A Trust

1. A court may exercise common law supervisory jurisdiction over the administration of a trusts. *State v. Rubion*, 308 S.W.2d 4 (Tex. 1957)

2. 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.

3. 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.

4. 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.

5. What does all this mean? In Texas courts do not routinely exercise jurisdiction over the administration of trusts (as they do, for example, with respect to the administration of guardianships). Notwithstanding this fact, 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 most instances, Courts will refuse to exercise this jurisdiction except in extraordinary situations. 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.

F. <u>Modification or Termination</u>

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:

ii. the purposes of the trust have been fulfilled or have become illegal or impossible to fulfill; or

iii. 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.

2. 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.

II. PERSONS ENTITLED TO BRING AN ACTION FOR BREACH OF FIDUCIARY DUTY

A. Standing

1. Trusts.

a. Texas Trust Code § 115.001 provides:

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

(a) construe a trust instrument;
(b) determine the law applicable to a trust instrument;
(c) appoint or remove a trustee;

(d) determine the powers, responsibilities, duties, and liability of a trustee;
(e) ascertain beneficiaries;
(f) make determinations of fact affecting the administration, distribution, or duration of a trust;
(g) determine a question arising in the administration or distribution of a trust;
(h) 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;
(i) require an accounting by a trustee, review trustee fees, and settle interim or final accounts; and
(j) surcharge a trustee.

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

iii. 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.

iv. The jurisdiction of the district court over proceedings concerning trusts is exclusive except for jurisdiction conferred by law on a statutory probate court. Tex. Trust Code Ann. § 115.001 (Vernon 1984).

The term "interested" person is defined in Texas Trust Code § 111.004(f).

A beneficiary of a trust may have standing to sue the trustee but may not have standing to sue an attorney representing the trust for legal malpractice. There may be no privity of contract between the beneficiary of a trust and the law firm representing the trust. Although a fiduciary relationship may exist between the beneficiary of a trust and a trustee, no fiduciary relationship may exist between the beneficiary of a trust and the

attorney representing the trustee. *Perry v. Vinson & Elkins*, 859 S.W.2d 617 (Tex. App. Houston, 1st Dist. 1993, writ denied).

B. Parties

1. Trusts.

1. Texas Trust Code § 115.011 provides:

1. Any interested person may bring an action under Section 115.001 of this Act.

ii. 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:

(a) a beneficiary on whose act or obligation the action is predicated;
(b) a person designated by name in the instrument creating the trust; and
(c) a person who is actually receiving distributions from the trust estate at the time the action is filed.

iii. The attorney general shall be made a party to and given notice of any suit or judicial proceeding relating to charitable trusts to the extent and in the manner provided by Article 4412a, Revised Statutes, as amended.

iv. 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. Tex. Trust Code Ann. § 115.011 (Vernon 1984).

2. Unknown Heirs and Unascertained Beneficiaries.

If there are unknown heirs or unascertained beneficiaries who would not be otherwise bound by the judgment by virtue of the doctrine of virtual

representation, see *Bradley v. Henry*, 239 S.W.2d 404 (Tex. Civ. App. - Fort Worth 1951, no writ) and Tex. Trust Code Ann. § 115.013 (Vernon 1984), then the court will appoint a guardian ad litem or attorney ad litem to represent theses interests.

3. Attorney General.

Texas Trust Code § 123.002 provides:

> 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. Tex. Trust Code Ann. § 123.002 (Vernon Supp. 1991).

C. 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 for breach of fiduciary duty may be brought by a beneficiary in his individual capacity against a person serving as a trustee in such person'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 is personally seeking to recover from

the trust estate of the trust rather than from the personal assets of the person serving as trustee.

An action for breach of fiduciary duty may also be brought by a beneficiary in his individual capacity against a person serving as a trustee in such persons individual capacity (rather than the persons fiduciary capacity). One example of this type of suit would be a suit by a beneficiary against a trustee to recover 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 is seeking to recover from the personal assets of the person serving as trustee (rather seeking recovery from the trust estate).

Finally, an action for breach of fiduciary duty may be brought by a beneficiary in a derivative capacity against a person serving as a trustee in such persons individual capacity (rather than the person's fiduciary capacity).

> 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 § 711 (1983);869 Bogert ,supra 92.*

In this type of suit the beneficiary is seeking recovery to the trust estate (rather than personally) from the personal assets of the person serving as trustee (rather than seeking recovery from the fiduciary estate).

III. JURISDICTION IN CASES INVOLVING BREACH OF FIDUCIARY DUTY

A. Suits Against Trustees

Jurisdiction over suits against trustees is usually in the district court. Texas Trust Code § 115.001(a) provides that "Except as provided in subsection (d) of this section, a district court has original and exclusive jurisdiction over all proceedings concerning trusts . .

." Subsection (d) provides that "the jurisdiction of the district court over proceedings concerning trusts is exclusive except for jurisdiction conferred by law on a statutory probate court. Texas Probate Code § 5A(c) provides "A statutory probate court has concurrent jurisdiction with the district court in all actions; . . . involving an inter vivos trust . . . involving a charitable trust; and . . . involving a testamentary trust." Tex. Prob. Code Ann. § 5A(c). The jurisdiction of a statutory probate court over trusts is concurrent with that of the district court regardless of whether or not the suit for breach of fiduciary duty is appertaining to or incident to an estate under administration. Tex. Prob. Code Ann. § 5A(d) (Vernon Supp. 1991).

IV. VENUE IN CASES INVOLVING BREACH OF FIDUCIARY DUTY.

A. Suits Against Trustees

1. Texas Trust Code § 115.002 provides:

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, venue is in the county in which the trustee's residence is located.

c. If any trustee is a corporation, venue is in the county in which the corporation's principal office is located, or, if two or more corporations are trustees of the trust, venue is in the county in which the principal office of any of the corporations is located.

d. If there are two or more trustee, none of which is a corporation, venue is in the county in which the principal office of the trust is maintained. Tex. Trust Code Ann. § 115.002 (Vernon 1984).

2. The venue provisions contained in Section 115.002 apply only to the specifically enumerated trust actions contained in Texas Trust Code § 115.001. If the cause of action is not in this list then this section of the trust code may not be applicable. *Mayflower Trust Co. v. Howell,* 413 S.W.2d 783 (Tex. Civ. App.--Houston 1967, writ dismissed).

V. LIABILITY FOR ACTS OF CO-TRUSTEES

A. Co-Trustees

1. Texas Trust Code § 113.085 provides:

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

i. a power vested in three or more trustees may be exercised by a majority of the trustees; and

ii. 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. Tex. Trust Code Ann. § 113.085 (Vernon 1984).

2. 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.

3. 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

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

VI. LIABILITY FOR ACTS OF PREDECESSOR TRUSTEES

A. Trustees

1. Texas Trust Code § 114.002 provides:

1. 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;

ii. fails to make a reasonable effort to compel the predecessor trustee to deliver the trust property; or

iii. fails to make a reasonable effort to compel a redress of a breach of trust committed by the predecessor trustee. Tex. Trust Code Ann. § 114.002 (Vernon 1984).

2. Restatement (Second) of Trusts, *supra,* § 223 provides that a successor trustee is liable for breach of trust if he:

a. knows or should know of a situation constituting a breach of trust committed by his predecessor and he improperly permits it to continue; or

b. neglects to take proper steps or compel the predecessor to deliver trust property to him; or

c. neglects to take proper steps to redress a breach of trust committed by his predecessor.

B. Exculpation

Particular attention should be paid to whether or not the trust contains a provision relieving the successor of liability to review acts of a predecessor. This type of exculpatory clause is probably valid in Texas insofar as it relates to successor trustees. *Steph v. Scott,* 480 F.2d 267 (5th Cir. 1983).

VII. AFFIRMATIVE DEFENSES TO CAUSES OF ACTION FOR BREACH OF FIDUCIARY DUTY.

1. Statute of Limitations

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.

a. 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.

b. 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.*

c. 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.

d. 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.

2. The Limitations Period

a. While the statute of limitations in Texas for breach of an express trust is unclear, the limitations period is probably four years. Courts have used both the two-year (Tex. Civ. Prac. & Rem. Code § 16.003, formerly Tex. Rev. Civ. Stat. Ann. art. 5526) and the four-year (Tex. Civ. Prac. & Rem. Code § 16.051, formerly Tex. Rev. Civ. Stat. Ann. art. 5529) statutes of limitations.

b. In 1944, the Texas Supreme Court appeared to adopt the four-year statute of limitations in *Peek v. Berry,* 143 Tex. 294, 184 S.W.2d 272 (Tex. 1944). In *Peek*, the court held that the four-year statute ordinarily applied to suits arising out of breach of trust. *Id.* at 275.

i. The Waco Court of Appeals has held that the four-year statute applies to the breach of a fiduciary relationship. *Graham v. Turner,* 472 S.W.2d 831, 836 (Tex. Civ. App. --Waco 1971, no writ) (citing *Peek*).

ii. Prior to *Graham*, the Waco Court of Appeals had held that "[i]t is well settled in Texas that where there is a trust relationship the four-year statute of limitations is applicable from the time that a party is charged to use diligence in making an investigation." *Blum v. Elkins,* 369 S.W.2d 810, 814 (Tex. Civ. App. -- Waco 1963, no writ).

c. Although in 1944 the Texas Supreme Court appeared to have adopted the use of the four-year statute in *Peek*, in 1945 the Court implied that the two-year statute was applicable. See *Slay v. Burnett Trust,* 1987 S.W.2d 377, 394 (Tex. 1945) (action not barred because beneficiaries filed suit within two years of learning of breach of trust). Unlike *Peek*, which involved a constructive trust, *Slay* involved an express trust. The two-year statute has also been applied to a former wife's breach of trust in failing to account for rent collected on property she owned as a joint tenant with her ex-husband. *Manning v. Benham,* 359 S.W.2d 927, 932 (Tex. Civ. App.--Houston 1962, writ ref'd n.r.e.).

2. Collateral Estoppel

3. Latches

4. Etc.

VIII. REMEDIES FOR BREACH OF FIDUCIARY DUTIES

A. Legal v. Equitable Remedies

Although the law is not well defined in Texas, initial inquiry should be made regarding whether the remedies sought for breach of fiduciary duty are legal or equitable. *Bogert, supra,* § 870. At common law, breaches of fiduciary duty were equitable causes of action and the equitable remedies available were much broader than the traditional legal remedies.

A recent Texas case dealt with the unique nature of equitable remedies. In *Arce v. Burrow,* 958 S.W.2d 239 [Tex. App.--Houston (14th Dist) 1998, no writ hist) the Court held that:

> As appellees point out in their brief on rehearing there is no common-law right to a jury trial in equity. See *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) (citing *Trapenell v. Sysco Food Serv. Inc.,* 850 S.W.2d 529, 543 (Tex. App.--Corpus Christi 1992), aff'd, 890 S.W.2d 796 (Tex.1994) Two provisions of the Texas Constitution, however, insure the right to a jury trial in Texas. See Tex. Const. art. 1, §15 and art. V, §10. Consequently, 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" *Fontenot,* 919 S.W.2d at 715 (quoting *Roy W. Mc Donald, Texas Civil Practice* §4:4 (rev. 1992). The law in Texas, then, is that the right to a jury trial extends to disputed issues of fact in equitable, as well as legal proceedings. *Fontenot,* 919 S.W.2d at 715. But, it is equally clear that a jury may not determine the expediency, necessity 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 v. Central Power and Light Co.,* 858 S.W.2d 359, 361 (Tex. 1993) "We hold that when properly requested, jury trials are appropriate for finding the ultimate issues of fact ... but not for fashioning appropriate equitable relief.

2. Balancing Losses against Gains

It is a well established equitable principal that a trustee who is liable for loss occasioned by one breach of trust cannot reduce the amount of his liability by deducting the amount of gain which has accrued through another and distinct breach of trust; but if the two

breaches are not distinct, the trustee is accountable only for the net gain or chargeable only with the net loss resulting therefrom. See *Restatement of The Law of Trusts, Second* § 213

3. Several Beneficiaries

1. *Restatement of The Law of Trusts, Second* § 214 provides that:

1. If there are several beneficiaries of a trust, any beneficiary can maintain a suit against the trustee to enforce the duties of the trustee to him or to enjoin or obtain redress for a breach of the trustee's duties to him.

2. If there are beneficiaries of a trust and the trustee commits a breach of trust for which there are two or more alternative remedies,

1. if none of the beneficiaries is under an incapacity and all agree upon a particular remedy, they are entitled to that remedy;

ii. if one or more of the beneficiaries is under an incapacity or they do not all agree upon a particular remedy, the court will enforce the remedy which in its opinion is most conducive to effectuating the purposes of the trust.

D. Trustees - Actual Damages

1. Texas Trust Code § 14.001 provides:

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.

3. 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 Section 113.056 or from any other breach of trust.

4. 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;

ii. any profit made by the trustee through the breach of trust; or

iii. any profit that would have accrued to the trust estate if there had been no breach of trust. Tex. Trust Code Ann. § 14.001 (Vernon Supp. 1991).

2. This provision of the Texas Trust Code adopts the Restatement (Second) of Trusts, *supra,* § 205.

3. Courts of equity may, in addition to the statutory damages outlined above, apply any type of remedy necessary to right the wrong.

E. Disgorgement of Fees

The Texas Trust Code §113.082, dealing with the removal of a trustee, specifically provides that "a court may remove a trustee **and deny part or all of the trustee's compensation**" (emphasis supplied).

Texas cases have held that a court of equity may order disgorgement of a fiduciary's fees for a mere breach of fiduciary duty (even if the fiduciary is not removed). See *Arce v. Burrow*, *supra.*

In *Arce* the court did not deal with the trustee/beneficiary fiduciary relationship. There does not, however, appear to be any public policy

consideration for not applying this remedy for breach of fiduciary duty to trusts.

The *Arce* court held that:

> "As a remedy for a breach of fiduciary duty, Texas has long recognized the concept of fee forfeiture in the principal-agent relationship....While we have found no Texas cases specifically involving fee forfeiture for a breach of fiduciary duty in the attorney-client relationship, we discern no reason to carve out an exception for breaches of fiduciary duty in the attorney-client relationship. Thus, we hold that fee forfeiture is a recognized remedy when an attorney breaches a fiduciary duty to his or her client."
>
> The court went on to hold that a plaintiff must prove a breach of fiduciary duty to be entitled to fee forfeiture, that fee forfeiture was not automatic but should be decided, on a case by case basis, by the judge of the court of equity, and that the factors that should be considered by the judge are: (1) the nature of the wrong committed by the fiduciary; (2) the character of the fiduciary's conduct; (3) the degree of the fiduciary's culpability, that is, whether the fiduciary committed the breach intentionally, willfully, recklessly, maliciously, or with gross negligence; (4) the situation and sensibilities of all parties, including any threatened or actual harm to the beneficiary; (5) the extent to which the attorney's or firm's conduct offends a public sense of justice and propriety; and (6) the adequacy of other available remedies.

6. Equitable Remedies

A court of equity is not confined to a limited list of remedies but rather will mold the relief to protect the rights of the beneficiary according to the situation involved. If equity cannot give the beneficiary the exact benefit to which the trust would entitle him, it will provide him the best possible substitute. See *Bogert, supra* §861.

7. Punitive Damages

Punitive damages are available in Texas for breach of fiduciary duty. They are available when the fiduciary commits a willful, malicious, or fraudulent wrong "which would include either self-dealing or another intentional breach of fiduciary duty," but would not require actual

malice. The amount of the Plaintiff's attorney's fees and related expenses may be a component of punitive damages. *Risser, supra,* at 907; *McLendon v. McLendon,* 862 S.W.2d 662 (Tex. App.--Dallas 1993); *Villarreal v. Elizondo,* 831 S.W.2d 474 (Tex. App.-- Corpus Christi 1992, no writ).

Any attempt to obtain punitive damages should involve a review of the recent case of *Transportation Insurance Company v. Moriel*, 879 S.W.2d 10 (Tex. 1994) This case sets forth the standards governing the imposition of punitive damages in the context of bad faith insurance litigation. Whether its principals will be applied to fiduciary litigation remains to be seen.

8. Attorneys' Fees

Texas Trust Code § 114.064 provides:

> 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. Tex. Trust Code Ann. § 114.064 (Vernon Supp. 1991).

If attorneys' fees are not recoverable under the Texas Trust Code they may be recovered as an element of punitive damages. *Risser, supra,*.

The standard for the award of attorneys fees in Texas Trust Code §114.064 is identical to the standard contained in Tex. Civ. Prac. & Rem. Code Ann. §37.009 (the Texas Uniform Declaratory Judgments Act). Note that under this standard (as applied to the Texas Uniform Declaratory Judgments Act) the court may award attorney's fees to a nonprevailing party. *McLendon v. McLendon,* 862 S.W.2d 662 (Tex. App.--Dallas 1993); *Hartford Cas. Ins. v. Budget Rent-A-Car,* 796 S.W.2d 763 (Tex. App.--Dallas, writ denied); *District Judges of Collin County v. Commissioners Court of Collin County*, 677 S.W.2d 743 (Tex. App.--Dallas 1984, writ ref'd n.r.e.)

Generally, the party seeking attorney's fees has the duty to segregate the attorneys' fees incurred for the claims where attorneys' fees are recoverable from those where attorneys' fees are not recoverable. *McLendon v. McLendon, supra*; *Stewart Title Guar. Co. v. Sterling,* 822 S.W.2d 1 (Tex. 1991); *Flint & Assoc. v. Intercon. Pipe & Steel*, 739 S.W.2d 622 (Tex.App.--Dallas 1987, writ denied).

An exception to the duty to segregate arises when the attorney's fees incurred involve claims arising out of the same transaction and their

interrelation is such that their prosecution or defense entails proof or denial of essentially the same facts. *McLendon v. McLendon, supra*; *Stewart Title Guar. Co., supra.* Therefore, when the causes of action involved in the suit are dependent upon the same set of facts or circumstances and thus are "intertwined to the point of being inseparable," the party suing for attorneys fees may recover the entire amount covering all claims. *McLendon v. McLendon, supra; Stewart Title Guar. Co., supra (*quoting *Gill Sav. Ass'n v. Chair King, Inc.* 783 S.W.2d 674, 680 (Tex. App.--Houston [14th Dist.] 1989), modified, 797 S.W.2d 31 (Tex. 1990); *Flint & Assoc., supra* at 624-625.

If an attorney is representing one beneficiary but recovers a judgment that benefits either the trust or other beneficiaries he or she should consider seeking attorney's fees out of the recovery that benefitted the nonclients under the Texas Common Fund Doctrine, *See Knebel v. Capital National Bank,* 518 S.W.2d 795 (Tex. 1974). A recent case outlining this doctrine (in a nontrust situation) is *Lancer Corporation v. Murillo,* 909 S.W.2d 122 (Tex. App.--San Antonio, 1995).

9. Removal of the Trustee

1. Texas Trust Code § 113.082 provides:

a. A trustee may be removed in accordance with the terms of the trust instrument, or, on the petition of an interested person and after hearing, a court may remove a trustee and deny part or all of the trustee's compensation if:

1. the trustee materially violates or attempted to violate the terms of the trust and the violation or attempted violation results in a material financial loss to the trust;

ii. the trustee becomes incompetent or insolvent; or

iii. in the discretion of the court, for other cause.

2. A beneficiary, co-trustee, or successor trustee may treat a violation resulting in removal as a breach of trust. Tex. Trust Code Ann. § 113.082 (Vernon 1984).

Note that removal under §113.082 (1) is limited to violation of the "terms of the trust" rather than breach of statutory or common law fiduciary duty.

In removal actions for breach of fiduciary duty under §113.082 (3) [as opposed removal actions for violating the express terms of the trust under §113.082(1)] question often arises regarding whether it is necessary to prove a "material breach" and "material financial loss to the trust" [as is apparently required under §113.082(1)]. It would appear that Texas Courts have determined that neither proof of a "material violation" nor proof of a "material financial loss to the trust" are prerequisites to removal under §113.082 (3).

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.

As a matter of practice a trustee will usually be removed under § 113.082(3) if he commits a breach of fiduciary duty.

J. Damages For Mental Anguish

Texas courts may award damages for mental anguish in a successful action for breach of fiduciary duty.

11. Deceptive Trade Practices Act

While the issue has not been finally settled in Texas, it is probable that the Deceptive Trade Practices Act is applicable to trustees. The Act provides for treble damages if the defendant is found to have acted knowingly. Tex. Bus. & Com. Code Ann. § 17.14 et seq. The Act also requires a demand letter prior to the institution of suit as a prerequisite to treble damages. In this author's opinion, if a breach of fiduciary duty

can be proven, the treble damages remedy available under the Deceptive Trade Practices Act is usually not as attractive as the punitive damage remedy, traditionally available for breach of fiduciary duties under the *Risser* doctrine.

PART THREE - MISCELLANEOUS CONSIDERATIONS

I. PRIVITY OF CONTRACT BETWEEN THE ATTORNEY DRAFTING THE TRUST INSTRUMENT AND THE BENEFICIARIES OF THE TRUST.

There is no privity of contract in Texas between the attorney who drafts a trust and the beneficiaries of the trust. This is true with respect to both negligence and contract (third party beneficiary) causes of action. See: *Barcelo v. Elliott,* ___ S.W.2d ___ (Tex. 1996).

II. PRIVITY OF CONTRACT BETWEEN THE ATTORNEY REPRESENTING THE TRUSTEE IN THE ADMINISTRATION OF THE TRUST AND THE BENEFICIARIES OF THE TRUST.

There is no privity of contract between the attorney who represents a trustee in the administration of a trust and the beneficiaries of the trust. See *Huie v. DeShazo*, 922 S.W.2d 920; Opinion No. 95-8073 (Tex.1996); *Thompson v. Vinson & Elkins,* 859 S.W.2d 617 (Tex. App.--Houston [1st Dist.] 1993, writ denied). This means that the beneficiary of a trust may not maintain a malpractice suit against an attorney who represents the trustee of his or her trust.

III. ATTORNEY CLIENT PRIVILEGE BETWEEN THE ATTORNEY DRAFTING THE TRUST INSTRUMENT AND THE BENEFICIARIES OF THE TRUST.

While there is no reported Texas case dealing with this issue, it is anticipated that the Texas Supreme Court would rule that a privilege would exist if the Trustor is alive. This is based on the rationale in the *Huie* case set forth herein.
If the Trustor is dead then Texas Rule of Evidence 503 (d) (2) might apply. This rule excepts from the lawyer-client privilege:

> a communication relevant on an issue between parties who claim through the same deceased client, regardless ow whether the claims are by testate or intestate succession or by inter vivos transactions.

IV. ATTORNEY CLIENT PRIVILEGE BETWEEN THE ATTORNEY REPRESENTING THE TRUSTEE IN THE ADMINISTRATION OF THE TRUST AND THE BENEFICIARIES OF THE TRUST.

There is an attorney client privilege between the attorney who represents the trustee in the administration of the trust and the beneficiaries of the trust. This privilege exists notwithstanding the trustee's duty of full disclosure to the trust beneficiaries.

The Texas Supreme Court has held that the attorney-client privilege protects confidential communications between the trustee and his or her attorney under Texas Rule of Evidence 503. See, *Huie v. DeShazo*, 922 S.W.2d. 920; Opinion No. 95-0873 (Tex. 1996) In reaching this decision the Supreme Court noted that:

> The attorney-client privilege serves the same important purpose in the trustee-attorney relationship as it does in other attorney-client relationships. A trustee must be able to consult freely with his or her attorney to obtain the best possible legal guidance. Without the privilege, trustees might be inclined to forsake legal advice, thus adversely affecting the trust, as disappointed beneficiaries could later pore over the attorney-client communications in second-guessing the trustee's actions. Alternatively, trustees might feel compelled to blindly follow counsel's advice, ignoring their own judgment and experience.

V. EXPEDITING DISCOVERY IN TRUST LITIGATION

Recall that trustees owe beneficiaries "a fiduciary duty of full disclosure of all material facts known to them that might affect [the beneficiaries'] rights." See *Huie v. DeShazo, supra* and *Montgomery v. Kennedy,* 669 S.W.2d. 309, 313 (Tex. 1984). This duty exists independently of the rules of discovery. *Huie, supra.* It is a separate breach of fiduciary duty for a trustee to refuse a beneficiary information to which he is entitled under the above stated rules. *See Montgomery v. Kennedy, supra; Bogert, supra* §961-974; *Scott, supra* §172-173; *Restatement (Second) of Trusts* §172-173.

These rules can be very helpful to the plaintiff in fiduciary litigation. Formal discovery is a very expensive and time consuming process. Gathering information in a case by a beneficiary against a trustee can be simplified by merely demanding in writing information from the trustee. If the trustee fails or refuses to provide the information within a reasonable time, then an action can be maintained pursuant to Texas Trust Code §115.001 to require the trustee to furnish the information (and to pay for the attorneys' fees and costs of the suit pursuant to Texas Trust Code §114.064).

VI. CONSEQUENCES OF ACCEPTING BENEFITS FROM A TRUST

If a beneficiary of a trust accepts benefits under the trust may he subsequently contest the validity of the trust? There is scant authority for the application of the so called "Acceptance of Benefits" theory in Texas Trust law. It is the Author's opinion, however, that properly presented, Texas courts will apply this doctrine to trust law.

There are numerous Texas cases holding that a person may not receive any benefits under a will and subsequently contest the Will. See: *In Re McDaniel,* 935 S.W.2d 827 (Tex. App. -Texarkana 1996); *Holcomb v. Holcomb,* 803 S.W.2d 411 (Tex. App. Dallas 1991); *Sheffield v. Scott,* 620 S.W.2d 691 (Tex. Civ. App. - Houston [14th Dist.] 1981, writ ref'd n.r.e.); *Trevino v. Turcotte,* 564 S.W.2d 682 (Tex. 1978); and *Aberg v. First National Bank In Dallas, et al.,* 450 S.W.2d 403 (Tex. Civ. App. - Dallas 1970, writ ref'd n.r.e.).

The lead case is *Trevino, supra.* In this case the Supreme Court held that:

> It is a fundamental rule of law that a person cannot take any beneficial interest under a will and at the same time retain or claim any interest, even if well founded, which would defeat or in any way prevent the full effect and operation of every part of the will.

In *Sheffield, McDaniel* and *Kellner v. Blaschke,* 334 S.W.2d 315, (Tex. App. - Austin 1960, writ ref'd n.r.e.) the court held that whether the devisees had knowledge of all facts and of all of their rights at the moment they accepted the benefits is immaterial to a determination that they, by their acts and conduct after acceptance, became estopped to contest the will.

The *Holcomb* and *McDaniel* cases deal with the relationship between property that would otherwise be available to the devisee (if the will were not probated) and the property that the devisee would take under the will. The *Holcomb* court held that a person who has received benefits under a will is not estopped to contest that will if the person would have received the same or a greater amount of benefit under another will of the testator or under the laws of intestacy. This holding was expressly rejected by the *McDaniel* court which held that "the proper test for determining whether a beneficiary under a will has received benefits which estop him from contesting that will is whether the benefits granted him by the will are or are not something of which he could legally be deprived without his consent."

The *McDaniel* court based this decision on the Texas Supreme Court's holding in *Wright v. Wright,* 274 S.W.2d 670 (Tex. 1955). The holding in the *Wright* case is both technical and confusing. The case involved a will that, to some extent, devised a life estate in both halves of certain community property to the surviving spouse and the remainder to friends of the testator. The Court held that:

> if the will disposes of property of the beneficiary and at the same time gives the latter some 'benefit', however small, the beneficiary cannot take the benefit under the will without accepting also the disposition it makes of his or her property. In the latter case, where a community interest is involved, the beneficiary must accordingly elect between taking under the will, with consequent loss as well as benefit, and, on the other hand, repudiating the will and taking only his or her community one half interest independently of the will.

The *Wright* court, further explained this holding as follows:

> The question of whether the benefits which the will purports to give are benefits within the doctrine of election is likewise one of law and, as before indicated, does not depend on the value of the benefits. Nor is it to be determined by comparing them with what the statutes of descent and distribution would afford the beneficiary in the absence of a will. If such were the test, the result in a case like the present, wherein there were no children of the testator, would be to regard the will as giving the respondent merely a part of what she was already entitled to, that is, the whole community estate. This is unsound, since her right to the whole is clearly subject to the testator's right to will his half to another. The proper test, therefore, is whether the alleged benefits granted her by the will are or are not something of which she could legally be deprived of without her consent. If they are, there is a benefit, which she can accept only by accepting also the burdens; if there are not there is no benefit and thus no case of election. Accordingly, a bequest to the respondent of the testator's one half of any part of the community estate is a benefit to her, although, absent a will, she would have inherited it and everything else.

The Acceptance Of Benefits Theory is not as well defined in trust law. The only case that comes close to this theory is *Traylor v. Orange,* 675 S.W.2d 802, 805 (Tex. App. -- Beaumont 1984, no writ). The *Traylor* court held that one cannot accept benefits under a testamentary trust and then contest the validity of the will creating the trust.

There is out-of-state authority for the proposition that, once a beneficiary accepts benefits from a trust, he cannot later attack the validity of the trust. In *Canning v. Bennett,* 245 P. 2d 1149, 1157, 206 OK. 675, 683 (1952), the Oklahoma Supreme Court held that, where a person sold a portion of her beneficial interest in a trust and had accepted thousands of dollars of benefits under the trust, she had over a period of years ratified the trust by long acquiescence and by acceptance of benefits thereunder, and she could not later be heard to question the validity of the trust, nor could her heirs be heard to question the validity of the trust after her death. *See also* Bogert, Trusts and Trustees, 2nd Ed. §170.

In Texas, acceptance by a beneficiary of an interest in a trust is presumed. Tex. Prop. Code Ann. §112.010(a). Nevertheless, most states in general and Texas in particular recognize the ability of a beneficiary to disclaim an interest in a trust. *See* Tex. Prop. Code Ann. §112.010. In Texas, one wishing to disclaim an interest in a nontestamentary trust may do so only if the person in his capacity as beneficiary has neither "exercised dominion and control over the interest" nor "**accepted any benefits from the trust**." Tex. Prop. Code Ann. §112.010(C)1 (emphasis added)

Thus, if a person accepts benefits from a trust (apparently even minor benefits) he may not later disclaim his interest in the trust. *See also Aberg, supra*.

Of course, disclaimers usually arise when one person wishes for property (in this case, trust benefits) to pass to another person for tax or creditor purposes. Texas' trust disclaimer statute merely tracks what is permitted by federal tax law with respect to disclaimers. Nevertheless, the existence of the disclaimer statute could help in raising an estoppel argument if a trust beneficiary attacks the validity of a trust even after accepting minor benefits therefrom.

PART FOUR - STRATEGIES

I. ADVERTISING

A. The Plaintiff's Perspective

If a corporate trustee is the defendant, the Plaintiff should consider obtaining copies of all advertising done by the corporate trustee. Corporate trustees often have pick-up brochures in their offices describing both their services and the fees charged for their services. Corporate trustees will sometimes advertise in newspapers and other magazines. They will sometimes send periodic newsletters to estate planning attorneys in their geographic area.

The Plaintiff should consider obtaining copies of both advertising that was made at the time that the trust was created (or in the case of a testamentary trust, the time that the will was drafted), as well as advertising during the term of the administration of the trust.

The advertising should be reviewed from two perspectives. First, from the perspective of the description of the quality of trust services rendered. Second, from the perspective of the description of the fees charged. The advertised fee should be compared to the fee actually charged by the trustee to determine if there are any "hidden" fees charged. Hidden fees often take the form of sweep fees, real estate commissions, special charges for the administration of mineral interests, tax preparation charges and other nondisclosed transactional fees.

Texas is not well defined on whether a corporate trustee is, per se, held to a higher standard of conduct than an individual trustee. Given an opportunity, a Texas Appellate Court will probably rule that a corporate trustee is held to a higher standard than an individual. See *Ertel v. Obrien,* 852 S.W.2d 17 (Tex. App.--Waco 1993, writ dismissed). In *Ertel* the court held a corporate executor to a higher standard of conduct than an individual.

B. The Defendant's Perspective

Attorneys representing corporate trustees should seek to review all of the institution's trust advertising. It is much easier to deal with the problem before the advertising is a factor in a lawsuit. The public relations persons drafting the advertising do not often consider the legal implications of their advertising. The ad should be absolutely accurate, especially in regard to trustees fees.

If a corporate trustee learns that the institution is charging a fee in excess of the fee disclosed to the public, the trustee should consider immediately refunding the excess fee to the trust estate of the trust. If the corporation is already involved in litigation, this may constitute an admission of liability but may reduce the amount of damages. Many judges and juries can be influenced by a defendant who admits to a mistake and immediately corrects it.

II. ATTORNEYS FEES

A. The Plaintiff's Perspective

The plaintiff should consider seeking an injunction enjoining the defendant trustee from using trust funds to defend the litigation. Not all courts will grant such an injunction. If the trustee does not have sufficient net worth to insure that he will be able to reimburse the trust estate in the event that he does not prevail, then some courts will prevent him from using trust assets to defend the case. This tactic seldom works on a corporate trustee.

B. The Defendant's Perspective

The defendant should try to use trust funds to defend the lawsuit. It is sometimes advisable to seek court instruction on the issue to prevent the plaintiff's attorney from making an issue of the payment of fees at trial.

III. BUILD A LITIGATION FILE

A. The Plaintiff's Perspective

All correspondence to the trustee or his attorney regarding demands (rather than settlement negotiations) should be drafted with the assumption that the correspondence will ultimately be an exhibit in the trial of the case. It is imperative that such correspondence portray the party that you are representing as reasonable and fair. Do not send threatening or abusive correspondence.

B. The Defendant's Perspective

The same rule applies to the defendant. Any response or correspondence should be drafted with the anticipation that it will be used against you at trial. Remember that the trustee is a fiduciary for the beneficiaries of the trust and must never appear to be hostile or abusive to them.

IV. CAPACITY

A. The Plaintiff's Perspective

The plaintiff should always give thought to the capacity in which the lawsuit is brought. Is the plaintiff suing individually or derivatively on behalf of the trust? The capacity in which the suit is brought may govern:

1. the type of cause of action that is brought,

2. the ability to recover legal fees from the trust estate, and, most importantly,

3. the measure of damages that may be recovered.

The plaintiff should also give thought to the capacity in which the trustee is sued. If the suit is brought against the trustee individually, then the recovery is limited to his or her personal funds. If the defendant is sued individually then he or she is less likely pay for the costs of defense from the trust estate of the trust. If the suit is brought against the trustee in a representative capacity then recovery is limited to the trust estate of the trust.

B. The Defendant's Perspective

The capacity in which the defendant is sued may govern his or her ability to defend the suit with trust assets.

V. CO-FIDUCIARIES

A. The Plaintiff's Perspective

A co-fiduciary will often be a co-defendant even if he or she did not actively participate in the breach of fiduciary duty. One co-fiduciary may not avoid liability by merely abrogating his or her fiduciary duties or delegating them to the other fiduciary. A trustee may have a fiduciary duty to monitor the competence of a co-fiduciary and to redress a co-fiduciary's breach of trust.

B. The Defendant's Perspective

A trust will frequently appoint co-trustees. One trustee is often more involved in the administration of the trust than the other. The more active trustee should not preempt the administration of the trust. While it is true that the passive co-trustee may have liability to third parties for the acts of the active trustee -- the passive trustee may have an action against the active trustee for reimbursement of his liability.

While it is permissible for the active trustee to perform many trust services unilaterally (such as preparation of accountings and tax returns of the sale or purchase of trust assets), the active trustee should supply the passive with information about the administration of the trust and should involve the passive trustee in all material discretionary decisions. The passive trustee always runs a high risk of liability for the unknown acts or omissions of his or her co-trustee.

VI. COLLECTIVE INVESTMENT

A. The Plaintiff's Perspective

The plaintiff should understand that corporate trustees invest trust assets in collective investments. These may now take the form of either common trust funds or mutual type funds. Most large corporate trustees have several of these funds. Most of the liquid assets of the trusts under administration are invested in one or more of these funds. In some instances separate transactional fees are charged within the fund that are never fully disclosed on the trust accountings. These funds present numerous and complex opportunity for fiduciary liability. If a large corporate trustee is the defendant in the litigation then the decision to invest in the particular fund, the performance of the fund, and the fees charged within the fund for administering (and or trading the securities) should all be carefully examined.

B. The Defendant's Perspective

The defendant's attorney should be careful to periodically review the performance of all of its collective investment vehicles as well as the legality of such investments. The defendant should remember that if he or she is sued for damages relating to an investment, then, according to a recent amendment to Tex. Trust Code Ann. § 113.056 (a), the trier of fact must take into consideration the investment performance of the entire trust portfolio rather than a single investment.

VII. COMMUNICATION

A. The Plaintiff's Perspective

The plaintiff's attorney should make sure that the client is aware of the financial and emotional costs of a lawsuit for breach of fiduciary duty. Most of my clients do not realize that fiduciary litigation, especially against family members, is very similar to divorce litigation. It is intensely emotional. Families frequently divide their loyalties between the litigants with the consequence that there is often the unanticipated destruction of personal and family relationships.

The client will often be subjected to intense emotional pressure to either settle or drop the litigation. The plaintiff's attorney should inform the client of this fact in advance and should make an independent evaluation of whether or not the client has the emotional strength to withstand this pressure.

Any litigation today is inherently time consuming and consequently very expensive. Prior to filing the lawsuit the client should also be fully informed of these facts and should begin the litigation without any false expectations regarding the time or expense involved in the process.

B. The Defendant's Perspective

The genesis of virtually every lawsuit against a trustee is a breakdown of communication between the trustee and its beneficiaries. A trustee should provide each beneficiary with:

1. an accurate and understandable periodic accounting of the trust;

2. notice of any non-routine transaction of a substantial nature in advance of the consummation of the transaction; and

3. access, if requested, to all trust property and documents pertaining to the administration of the trust.

It is advisable to schedule periodic meetings with the beneficiaries to review the administration and performance of the trust. Contingent beneficiaries named in the trust instrument should be included in these meetings. Special meetings should be scheduled to discuss non-routine transactions of a substantial nature before they are entered into. At these meetings the trustee should be alert to any concerns the beneficiary has about the administration of the trust. If concern is expressed the trustee should attempt to explain to the beneficiaries why the decision is being made. If the decision is material and substantial and if any beneficiary is unalterably opposed to it,

then the trustee should consider court instruction, or a judicial determination of liability while the transaction can still be reversed.

VIII. CONFLICT OF INTEREST

A. The Plaintiff's Perspective

Many conflicts of interest are self-evident. Others are more difficult to identify and address. Perhaps the most troublesome and obscure conflicts problems arise with respect to transactions by a corporate trustee that affect the commercial bank or an affiliate of the bank. This is demonstrated vividly in *Risser, supra*. In this case a trustee was found to have violated its fiduciary duty of loyalty by making an investment that indirectly made it easier for a corporation to repay its debt to the commercial bank.

Corporate trustees are particularly vulnerable to allegations of breach of the duty of loyalty when the commercial bank undertakes any material transaction with a co-trustee, a beneficiary, or a third party entering into a commercial transaction with the trust.

If the lawsuit involves a conflict of interest then there may be an issue of constructive fraud. If the trustee receives personal benefit from any discretionary decision in the administration of the trust then the burden of proof shifts and the trustee must prove that the decision was fair. If constructive fraud exists then it should probably be pled in the lawsuit.

Breaches of the fiduciary duty of loyalty (involving a conflict of interest) often result in the highest damage awards. These cases are most likely to offend a judge or jury.

B. The Defendant's Perspective

Before making any discretionary administrative decision the trustee should consider what effect, if any, the decision will have on the trustee or anyone related to the trustee. If the decision benefits a related party in any way then a legal opinion or declaratory judgment should be obtained prior to implementing the decision.

IX. CONSENT OF THE TRUST BENEFICIARIES

A. The Plaintiff's Perspective

If a client has consented to a trust transaction then the plaintiff's attorney should consider whether the client has been provided all of the relevant information necessary to reasonably make such a decision. If such information has not been provided then the consent may not be valid.

B. The Defendant's Perspective

If a trustee is faced with a particularly difficult administrative decision it should consider obtaining the written consent of the beneficiaries of the trust. Such a consent will only protect the trustee if all relevant information regarding the decision is disclosed to the beneficiary. Even if some of the beneficiaries are unable to consent (because of incapacity or minority) the trustee should attempt to obtain consents from those beneficiaries who have capacity to consent -- this will at least eliminate the beneficiaries who have consented from the prospective class of plaintiffs who may later sue the trustee.

X. CORPORATE POLICY MANUALS AND TRUST COMMITTEE MINUTES

A. The Plaintiff's Perspective

If a corporate trustee is the defendant, the Plaintiff's attorney should obtain copies of all Policy Manuals and Trust Committee Minutes. These documents are fertile ground for the establishment of fiduciary liability.

Most corporate trustees have trust policy manuals. A trust policy manual sets out the institution's procedures for administering trusts. The policies in these manuals are sometimes ignored by the officer administering the trust account. These manuals should be reviewed from two perspectives. First, are the procedures set forth in the manual consistent with current fiduciary duties? Second, has the institution applied the procedures in the manual to the trust that is subject to the litigation?

Trustees should also be aware of the fact that terms in the trust instrument may dictate that the trust be administered in a manner that is inconsistent with the institution’s policy manual. It is very important not to blindly follow the policies in the manual without reconciling the policies with the instrument creating the trust.

Most corporate trustees have directors trust committees and officers trust committees. These committees either approve or actually decide material

questions in the administration of each trust administered by the institution. These are usually separate committees. Minutes are kept of the committee proceedings. These minutes should be sought in discovery and reviewed from two perspectives. First, was a transaction that is subject to litigation considered by the committee? If it was, then what criteria were applied in making the decision to enter into the transaction? Were these considerations consistent with the institutions fiduciary duties and the institutions trust policy manual? It is very difficult to prove by oral testimony that a trustee applied criteria or considered factors other than those disclosed in the trust files or trust committee minutes. Second, if the transaction was not considered, should it have been? From the plaintiff's perspective the omission of any consideration of the transaction may be very important in establishing fiduciary liability.

B. The Defendant's Perspective

Attorneys representing corporate trustees should recommend that the trust policy manual be reviewed at least annually. It is imperative that the trust policy manual be annually updated to reflect changes in trust law. It is also important that the manual not contain any language that would constitute a per se breach of fiduciary duty.

If a policy manual exists it is important that the policies be followed in the administration of the trust -- if a policy is not followed then there should be a written explanation in the trust file explaining the unique circumstances that necessitated deviation from the policy.

Corporate trust officers should also be familiar with the *Fiduciary Powers of National Banks and Collective Investment Funds*, 12 CFR 9. While breach of these regulations is not the basis for liability in a third party lawsuit, some judges will allow the fact that these regulations have been breached into evidence.

Attorneys should also periodically review the procedures and minutes used by the institution's trust committees. The members of the committee should be encouraged to carefully document the reasons for material trust decisions. If the decision is "high risk" the attorney should recommend that he or she attend the meeting to insure that the proper considerations are made and that the considerations are properly reflected in the minutes. If the decision is particularly "high risk" the members of the committee should consider obtaining a legal opinion regarding the decision or at least the criteria that they should consider in making the decision or obtaining instruction from the court.

XI. DEFINE THE CAUSES OF ACTION

A. The Plaintiff's Perspective

Most plaintiff's attorneys who are not experienced in fiduciary litigation file pleadings that give no clue whatsoever what the defendant has done wrong. Most of these attorneys simply plead that "the defendant has breached his fiduciary duties to the defendant" and that such breach has caused damage to the plaintiff.

Be specific in your pleadings. Specify the fiduciary duties that have been breached and identify the facts that support both the breach and the damages sought. This will save your client the time and expense of addressing special exceptions and will cause the defendant to take your case much more seriously than if you plead general breaches of duty.

B. The Defendant's Perspective

It is imperative that the defendant specifically identify the cause of the lawsuit as soon as is practically possible. It may be possible to settle the case on relatively minor claims before the discovery escalates the suit into a major cause of action. The defendant should not go to trial on general pleadings that do not specify the factual and legal bases of the causes of action. One of the first pleadings that should be filed is special exceptions to require the issues to be narrowed as much as possible.

XII. DISCOVERY

A. The Plaintiff's Perspective

A trustee has a fiduciary duty to keep accurate books and records and to make them reasonably available for inspection by the trust beneficiaries. Sometimes substantial time and money can be saved by asking the trustee to examine and copy all of the books and records of the trust. If the trustee refuses to allow examination of the books and records such refusal may constitute a separate breach of fiduciary duty.

B. The Defendant's Perspective

A trustee receiving a request for examination of the books and records of the trust should usually comply with the request. Failure to comply may result in an independent breach of fiduciary duty.

XIII. DISCRETIONARY DECISIONS

A. The Plaintiff's Perspective

A typical trust instrument will authorize a trustee to make numerous discretionary decisions with respect to the administration of a trust. These will include discretionary investment decisions, discretionary allocation of receipts and disbursements between the principal and income accounts, discretion with respect to depreciation, depletion and amortization and possibly discretion in determining what constitutes principal and what constitutes income. It is important to remember that almost every discretionary decision involves the fiduciary duty of impartiality (*i.e.*, a potential conflict between the interests of the income beneficiaries and the remainderman). As a consequence discretionary decisions are the basis for a substantial amount of trust litigation.

A trust may also provide that a trustee may make purely discretionary distributions of income or principal. In this type of trust a beneficiary may not sue the trustee to compel a distribution. The plaintiff's attorney should recognize the difference between "abuse of discretion" and "failure to exercise discretion" and the incident liability that flows from both of these breaches of fiduciary duty.

The plaintiff should recognize that provisions in the trust instrument specifying that the trustee's discretion is "absolute" may not relieve the trustee from acting reasonably.

The fact that a beneficiary cannot sue a trustee of a purely discretionary trust to compel a distribution does not mean that the beneficiary may not sue the trustee for abuse of discretion. In an abuse of discretion case, it is imperative that the plaintiff's attorney discover the exact criteria applied by the trustee in making the discretionary decision and what facts were known to the trustee at the time that the decision was made. These are the two factors upon which the reasonableness of the discretionary decision is weighed.

B. The Defendant's Perspective

In making a discretionary decision a trustee should consider and document the factors outlined in PART ONE above.

XIV. DOCUMENTATION OF TRUST DECISIONS

A. The Plaintiff's Perspective

The plaintiff should seek, through discovery, virtually all of the books and records of the trustee that relate in any way to the administration of the trust. Corporate trustees in particular should have records that will to some extent reflect the criteria used in making decisions regarding the administration of

the trust. Frequently these criteria will be in conflict with the trust instrument or their fiduciary duties.

B. The Defendant's Perspective

A trustee should be careful to document the reasons for material trust decisions. If the decision is within the discretion of the trustee, a court will not substitute its discretion for that of the trustee unless there is a clear abuse of discretion. A log should be kept which documents the substance of all material conversations with trust beneficiaries, attorneys, accountants and other persons the trustee deals with in the administration of the trust. If a trustee relies on agents to perform trust services, its files should reflect the criteria used to hire them as well as any instructions that are given to them. The trustee should carefully document all steps taken in acquiring, retaining, or disposing of material trust investments.

If the trustee is a corporation then the Directors and Officers Trust Committee should meet and carefully document both their decisions and the information upon which these decisions are based. The minutes of these meetings are usually requested by a plaintiff in a trust litigation suit.

XV. DO NOT TAKE UNREASONABLE POSITIONS

A. The Plaintiff's Perspective

The party that prevails in a lawsuit for breach of fiduciary duty is usually the party that convinces a judge and/or jury that he or she is the most reasonable in his or her demands. Do not file pleadings that overstate your case or make allegations that you cannot prove in court. If you have a winnable cause of action, go with it! Do not pollute your pleadings with fictitious allegations that will detract from your position.

B. The Defendant's Perspective

The defendant is in a very difficult position when sued for breach of fiduciary duty. If the trustee has clearly breached the duty, consider admitting the breach and argue about damages. Avoid the temptation to play "hard ball" with the trust beneficiaries - this tactic often backfires. The damage award is almost always lower in cases where the trustee admits an honest mistake than in cases where a trustee who has obviously breached his or her fiduciary duty unreasonably maintains that he or she did nothing wrong.

XVI. EMPLOY COMPETENT TRUST COUNSEL

A. The Plaintiff's Perspective

There are an increasing number of attorneys in Texas who specialize in fiduciary litigation. An attorney faced with a substantial breach of fiduciary duty lawsuit should consider at least consulting with someone specializing in the field to identify the specific causes of action and perhaps serve as co-counsel in the proceeding.

B. The Defendant's Perspective

If a trustee does not know how to construe a trust instrument, does not clearly understand the extent of a trust power or does not know the criteria he should use in making a discretionary decision, then he should seek a legal opinion from competent trust counsel. There is an unwritten policy in Texas that trustees will use the attorney who drafted the instrument to represent the trust. While this rule usually works, if the attorney who drafted the trust is clearly not an expert in trust law, then a legal opinion regarding the trust should be sought from a trust specialist. While a legal opinion will not always protect the trustee from liability it might, at least, mitigate the damages arising from the transaction.

The attorney who drafted the instrument appointing the trustee may not be the person best suited to defend the trustee if a lawsuit is filed against the trustee. An estate planning specialist or a trial lawyer who does not normally handle fiduciary litigation matters may not be able to represent the trustee as competently as an attorney who specializes in fiduciary litigation.

XVII. ENVIRONMENTAL PROBLEMS

A. The Plaintiff's Perspective

Toxic tort litigation is very complicated and is frankly beyond the scope of this paper. If there is a possibly that such a cause of action exists, a specialist should probably be consulted.

B. The Defendant's Perspective

Prior to agreeing to administer any trust property that could possibly be subject to environmental problems the trustee should, if there is realistic concern, do an environmental audit to determine the nature and extent of any liability to the trust. This is especially true if the trust property is high risk property such as property with oil and gas production, underground storage tanks, etc.

XVIII. EXCULPATORY PROVISIONS

A. The Plaintiff's Perspective

The plaintiff's attorney should first realize that, while exculpatory provisions may sometimes act to protect a trustee from liability, they offer very limited protection to the trustee.

Most exculpatory clauses are drafted too broadly. As noted above in the discussion of exculpatory clauses, the public policy of this state severely limits the extent to which a trustee may be exculpated. Many estate planners draft exculpatory clauses that are vastly broader than allowed. See *Risser, supra.* Consequently, the plaintiff's attorney should not assume that the language in the instrument is valid, especially if the language attempts to exculpate the trustee from simple negligence or breach of fiduciary duty.

An exculpatory clause may be attacked in its entirety if the attorney who drafted the clause is also the trustee. While there are no decisions currently on point in Texas, an exculpatory clause may also be subject to attack if the attorney who drafted the will also represents the financial institution serving as trustee.

It is difficult to comprehend why any trustor would want to exculpate an independent unrelated trustee who is charging a fee for his or her services. If a trustee breaches a fiduciary duty, why would a trustor want the beneficiaries of his or her trust to suffer material financial loss so that the fiduciary who is being paid to administer his or her trust can be exculpated from liability?

The Plaintiff’s attorney should always be aware of the difference between an exculpatory clause and a limitation or modification of fiduciary duty. Is the clause really an exculpatory clause?

B. The Defendant's Perspective

A trustee should never rely on an exculpatory clause (or a clause limiting the trustees fiduciary duties) to protect him or her from liability for breach of a fiduciary duty. A trustee should advise never make a decision in the administration of the trust in reliance on an exculpatory clause. A trustee should never rely on requests or representations by a beneficiary or a co-trustee in making trust decisions. The trustee should be advised that the trustor charged him or her, rather than the beneficiary, with responsibility for administering the trust.

XIX. PROBLEM ACCOUNTS

A. The Defendant's Perspective

A trustee should be sensitive to the potential for litigation prior to accepting any trust. If the beneficiaries have a history of participating in litigation, if there is acrimony between beneficiaries, or if there is acrimony between the beneficiaries and the trustee, then the trustee should carefully weigh the benefit of the fees charged against the potential for liability for administering the trust.

XX. REVIEW OF TRUST INVESTMENTS

A. The Plaintiff's Perspective

If there has been a substantial decline in the value to the trust estate during the administration of the trust the cause of the decline might be the trustee's lack of diligence in monitoring the trust portfolio. If such a situation exists then the plaintiff's attorney should discover the frequency that the trustee reviewed the particular investment.

B. The Defendant's Perspective

Most corporate trustees invest the majority of trust assets in collective investment funds that are reviewed periodically. Many trusts, however, contain special assets such as the family farm, stock in the family business, or oil and gas properties.

An individual trustee is much less likely to utilize a collective investment fund. A trustee should periodically review these assets and document its files with both the results of such review and its reasons for retaining the asset.

XXI. THREATS OF LITIGATION

A. The Defendant's Perspective

If a beneficiary of a trust threatens litigation the trustee should immediately evaluate the merit of the beneficiary's claim and should try to resolve the dispute without litigation. Many unnecessary trust lawsuits are the result of the actions the trustee takes after learning of the beneficiary's claim. The trustee should avoid institutional arrogance or an excessively defensive attitude in dealing with the beneficiary. In many instances a meeting should be scheduled with the beneficiaries asserting the claim and an attempt should be made to resolve the matter. The trustee should determine if the claim has merit. If the claim has merit then the trustee should weigh the cost of litigation and the potential for punitive damages against the costs involved in an immediate settlement of the dispute.

XXII. TRUST ACCOUNTINGS

A. The Plaintiff's Perspective

Trust accounting is, in essence, the allocation of receipts and disbursements between the principal and income accounts. Most corporate trustees are experienced in preparing and keeping trust accountings. Most individual trustees are not. Many certified public accountants have no experience with trust accounting.

A trustee, of course, is required to keep accurate books and records reflecting the condition of the trust. In order to calculate the net income of the trust it is necessary to prepare trust accountings. Each allocation of receipts and disbursements involves the fiduciary duty of impartiality. Whether an allocation is made to income or principal accounts the beneficial interests of both the income beneficiaries and the remainder beneficiaries of the trust. If the trust instrument is silent then the Texas Trust Code controls the allocation. If the trust instrument grants discretion to the trustee then the fiduciary duty of impartiality may control the allocation.

Trust accounting problems also arise with respect to the creation of reserves for amortization, depletion and depreciation. Whether or not these reserves are taken will affect the interests of the income beneficiaries and remaindermen. Again, if the trust instrument is silent, the Texas Trust Code will control the allocation. If the trust instrument grants discretion then the duty of impartiality may control the allocation.

Trust accounting problems may exist even if there is a corporate trustee. Most corporate trustees use software programs to prepare trust accountings. These programs are often inadequate to handle special situations. Some software programs are prepared for national use and may be inconsistent with the Texas Trust Code. If the trustee is a corporation, discovery should include an analysis of the method by which trust accountings are prepared. Never assume that the software used by the bank to prepare the accountings is correct!

Trust accounting problems are most frequently encountered when there is an individual trustee. Individual trustees rarely do it right. In every lawsuit where there is an individual trustee, trust accounting problems are likely to exist.

Most breach of fiduciary suits should begin with an examination of the trust accounting. If the beneficiary does not possess a current accounting one should be demanded from the trustee.

B. The Defendant's Perspective

An individual trustee should be particularly sensitive to trust accounting problems. Even if discretion is granted with respect to the allocation of receipts and disbursements, the allocations contained in the Texas Trust Code usually provide a "safe harbor." A trustee should not necessarily rely on a certified public accountant to prepare the trust accountings. Inquiry should be made regarding the accountant's prior experience in fiduciary accounting. Particular care should be given to making and documenting discretionary allocations.

XXIII. THE TRUST INSTRUMENT

A. The Plaintiff's Perspective

Any attorney representing a client in trust litigation should carefully review the trust instrument. While reviewing the instrument the attorney should develop a clear understanding of the powers, duties and responsibilities of the trustee. While reviewing the instrument, the attorney should consider potential causes of action other than those described in the initial interview with the client. Clients often have little, if any, real understanding of the application of fiduciary duties and consequently often fail to recognize causes of action.

While reviewing the trust instrument the attorney should pay particular attention to any clauses that exculpate the trustee or indirectly limit the trustee's liability. The existence of such a clause may have a material impact on the plaintiff's ability to recover for the cause of action initially described by the client.

In discovery, inquiry should be made into the trustee's knowledge of the terms of the trust instrument. This inquiry should begin with specific questions regarding the terms and provisions of the trust and should conclude with inquiry about how often the trust instrument has been read or reviewed by the trustee.

B. The Defendant's Perspective

It is impossible to administer a trust without a complete understanding of the instrument creating the trust. While this fact should be self-evident, it is surprising how many lawsuits arise from a misconstruction or misapplication of a specific provision in the trust. An attorney representing the trust should make it clear to the trustee that if he or she does not understand a provision in the trust, he or she should not hesitate to seek a legal opinion or, if necessary, a construction suit to clarify its meaning. The instrument creating the trust should be periodically reviewed by the trustee and outlined if necessary.

XXIV. TRUSTEES FEES

A. The Plaintiff's Perspective

The plaintiff should carefully compare the trustee's fees actually charged by the trustee to the fee provisions in the trust and to local standards. The attorney should inquire in discovery about hidden fees that are not reflected on the trust accounting.

Several years ago the Texas Legislature passed a statute providing for the "unbundling" of trust services. See Tex. Trust Code Ann. §113.053 (f). This allowed corporate fiduciaries to provide services through affiliates that were previously provided directly by the trustee. One example of an "unbundled" trust service would be stock brokerage firm owned by a corporation affiliated with the trustee. The broker would charge separate fees for trading securities. If the trustee is a corporation, investigation should be made regarding what activities relating to the trust are performed by affiliates of the trustee and what is being charged for these services.

Corporate trustees will often hold cash in trust accounts. In the early 1980's, computer technology made it cost-effective to invest small sums of idle cash for short periods of time. In addition various money market funds, which were suitable short-term investments became available. Some corporate trustees began offering a service known as "sweeping". A sweep looks daily for idle cash and invests it in a interest-bearing vehicle until the cash is either invested long-term or distributed to the beneficiary. Corporate trustees charge a fee for this service in addition to their normal and customary trustee's fee. Class Action litigation has been brought in other states regarding whether the imposition of these fees violates a trustee's fiduciary duty or are deceptive trade practices. See *Upp v. Mellon Bank, N.A.*, 994 F. 2d 1039 (U.S. Ct. of App. - 3rd Cir, 1993); *Simpson v. Mellon Bank*, Civil Action No. 93-4054, Civil Action No. 93-4722 (U.S. Dist.- E. Dist. of Penn - 1993); and *Vogt v. Seattle-First National Bank*, 117 Wash. 2d 541; 817 P. 2d

1364 (Wash. 1991) The issue has not been litigated in Texas. Texas has a statute governing a trustee's compensation, Tex. Trust Code Ann. § 114.061[2]. Texas has no statute specifically allowing "sweep fees". Texas is ripe for a class action suit determining the validity of these fees if they are charged. The suit would be either for breach of fiduciary duty of a violation of the Texas Deceptive Practices - Consumer Protection Act.

B. The Defendant's Perspective

The trustee should carefully review the instrument and become familiar with customary local fees for trust services. The trustee should be particularly concerned with undisclosed fees that are charged to the trust.

If there is question about the amount of fees that may be appropriately charged then the trustee may consider seeking instruction from the court at the time the trust is accepted.

The defendant's attorney should advise his or her client that it is imperative that the unbundled trust services provided by the trustee be comparable in quality and cost to similar services available to the trustee from non-affiliates and that fees charged for these services be fully disclosed in trust department advertising and in representations to both trustors and trust beneficiaries.

XXV. THE JURY

A. Remember Your Audience This valuable advice is taken without change from Joyce Moore's excellent paper ***The Impact of a Fiduciary Relationship In Civil Litigation.***

Even though the makeup of jury panels will vary considerably from one part of the state and country to the next, there are certain traits in common in the majority of panels that may be helpful to consider:

1. Expect no more than a high school education; hope they all speak English fluently;

2. On average, anticipate that they will earn approximately $15,000 to $25,000 per year;

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[2] Which provides that " Unless the terms of the trust provide otherwise and except as provided in Subsection (b) of this section [which deals with the denial of trustee's fees in the event of a trustee's breach of trust], the trustee is entitled to reasonable compensation from the trust for acting as trustee."

3. Realize that most jurors will not need or have sophisticated estate plans or trusts of their own, and may not like anyone who does;

4. They do not trust lawyers and resent legal intrusions into the management of their personal affairs;

5. At least one-half of the women on the panel will resent any inference or suggestion that the wife or daughter is not mentally competent (in a business sense or otherwise) to handle money, the other half of the women would love to "be taken care of;"

6. Over half of the men would love to tie up the money so their wife (or daughter) couldn't "waste" it;

7. All of the men will be horrified at any suggestion that a grown man shouldn't have complete control of his funds;

8. Either they or someone they know has experienced a family dispute over an inheritance or a gift;

9. They expect any fiduciary who has been paid "real money" for his services to be close to perfect;

10. They have all felt cheated at some time or another by someone they trusted;

11. They have better things to do than to sit in some courtroom day after day listening to people fight over large sums of money while they won't even get enough from their jury service to cover their parking and lunch costs;

12. Small children are protected, adult children who are living on parental money are viewed with distaste and suspicion;

13. If they can't understand what you wrote they will make up what they think is fair;

14. Most of the time they will do what is right in spite of the most sophisticated attempts to draft language exculpating the fiduciary.