

TRUSTEE DUTIES

AVOIDING LITIGATION & DEFENDING THE TRUSTEE



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- State Bar of Texas 25th Annual Advanced Estate Planning and Probate Course, June 2001
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- Attorneys in Tax and Probate Conference, April 2002;
- Tarrant County Probate Bar Litigation Seminar, April 2002
- HBA Wills and Probate Institute at South Texas College of Law, January 2003

- State Bar of Texas 29th Annual Advanced Estate Planning and Probate Course, June 2005
- South Texas College of Law Wills and Probate Institute, September 2006
- HBA Probate, Trusts & Estates Section Meeting, November 2008
- State Bar of Texas Advanced Guardianship Course, April 2010 (as *Gunfight at the OK Corral: Litigation and Discovery Issues*)
- South Texas College of Law Wills and Probate Institute, September 2010

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- All Texas state courts



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- State Bar of Texas (Litigation and Oil and Gas sections)
- Houston Bar Association (Director, Litigation Section, 2002 - 2003)
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LESSONS

- Know the big three duties of a trustee.
- Understand that a trustee's duties limit its powers.
- Read the trust instrument.
- Make sure the trust investment committee and trust advisory committee are working in sync.
- Follow the proper decision-making process of a trustee.

LESSON #1

Know the Big 3 Duties of a Trustee:

Duty of Loyalty

Duty of Care

Duty of Full Disclosure

Every other duty of a trustee flows from one of these duties, or is a combination of one of these duties. For example:

- The duty to treat trust beneficiaries impartially is part of the duty of loyalty.
- The duty to diversify the trust portfolio is part of the duty of care.
- The duty to keep adequate books and records combines the duty of care and the duty of full disclosure.

DUTY OF LOYALTY

“A trustee shall invest and manage the trust assets solely in the interest of the beneficiaries.”

- UNIF. TRUST CODE § 802(a); TEX. TRUST CODE § 117.007.
- The duty is to place the beneficiaries’ interests above the trustee’s.
- Duties include:
 - Duty not to self-deal
 - Duty not to profit from trust
 - Duty to treat beneficiaries impartially
- The duty of loyalty is not limited to settings entailing self-dealing or conflict of interest in which the trustee would benefit personally from the trust.

DUTY OF LOYALTY

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

- *Meinhard v. Salmon*, 249 N.Y. 458, 464, 165 N.E. 545, 546 (1928) (Cardozo, J.).

DUTY OF LOYALTY—NO SELF-DEALING

“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.”

- *Magruder v. Drury*, 235 U.S. 106, 119, 35 S. Ct. 77, 82, 59 L. Ed. 151, 156 (1914).

“The trustee is under a duty to the beneficiary in administering the trust not to be guided by the interest of any third person. Thus, it is improper for the trustee to sell trust property to a third person for the purpose of benefitting the third person rather than the trust.”

- RESTATEMENT (SECOND) OF TRUSTS § 170, cmt. q, at 371 (1959).

DUTY OF LOYALTY—NO SELF-DEALING

- Self-dealing transactions include:
 - Buying assets from or selling assets to the trust.
 - Lending to or borrowing from the trust.
 - Investing trust funds in the trustee's own securities (with some exceptions).
 - Doing any of these with an affiliate of the trustee.
 - Taking "double-dip" compensation.
 - Getting kickbacks from third parties with whom the trustee deals or invests trust funds.
 - Investing trust funds so as to benefit other customers of the corporate trustee or inflate the trustee's own bottom line.
- Self-dealing transactions can be authorized by trust instrument, beneficiaries, or court, but still must be fair to the beneficiaries.

DUTY OF LOYALTY—ACCOUNTING FOR PROFITS

“A trustee who has received a commission or bonus, or made a profit for himself ... is required to account to his beneficiary for it. The profits so made belong to the [beneficiary] and for his full protection the [beneficiary] may have the use of the constructive trust as a remedy.”

- *Slay v. Burnett Trust*, 143 Tex. 621, 640, 187 S.W.2d 377, 388 (1945).

“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; nor can they put the funds into the trade or business of another, under a stipulation that they shall receive a bonus or other profit or advantage. 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.”

- 1 JAIRUS W. PERRY, A TREATISE ON THE LAW OF TRUSTS & TRUSTEES § 429, at 714–16 (7th ed. 1929).

DUTY OF LOYALTY—IMPARTIALITY

“If a trust has two or more beneficiaries, the trustee shall act impartially in investing, managing, and distributing the trust property, giving due regard to the beneficiaries’ respective interests.”

- UNIF. TRUST CODE § 803; TEX. TRUST CODE § 117.008.

“The duty of impartiality arises from the duty of loyalty. When the trustee owes duties to more than one beneficiary, loyalty requires the trustee to respect the interests of all beneficiaries.”

- UNIF. PRUDENT INVESTOR ACT § 6 cmt.

“Prudence in investing and administration requires the trustee to take account of the interests of all the beneficiaries for whom the trustee is acting, especially the conflicts between the interests of beneficiaries interested in income and those interested in principal.”

- *Id.*

DUTY OF LOYALTY—IMPARTIALITY

- The Uniform Principal and Income Act determines which receipts and expenses are allocated to principal v. income.
 - This is important because some trusts have different distribution standards for principal and income, e.g., mandatory income distribution annually, principal retained until trust ends.
- Trustees have discretion with allocation of some amounts.
 - For example, if a trustee receives money “as a royalty, shut-in well payment, take-or-pay payment, or bonus, the trustee shall allocate the receipt equitably.” TEX. TRUST CODE § 116.174(a)(3).
- Trustees also can adjust between principal and income in certain circumstances.
 - This allows trustees to invest in a portfolio that provides a higher total return (e.g., growth stocks that do not pay dividends) without having to realize a portion of the portfolio’s total return in trust income (e.g., interest, dividends, and rents).
- Trustees can be held liable if they abuse this discretion.

DUTY OF CARE

“The trustee is under a duty to the beneficiary in administering the trust to exercise such care and skill as a man of ordinary prudence would exercise in dealing with his own property.”

▪ RESTATEMENT (SECOND) OF TRUSTS § 174 (1959).

- Duties include:
 - Duty to act according to trust instrument.
 - Duty to act according to law governing trust.
 - Duty to act prudently in administration of trust.
 - Duty to invest trust assets prudently through diversification and risk/reward balancing.
 - Duty to take reasonable steps to control and protect the trust property.
 - Duty to investigate and monitor trust assets and investments.

DUTY OF CARE—DUTIES AT INCEPTION

“Within a reasonable time after accepting a trusteeship or receiving trust assets, a trustee shall review the trust assets and make and implement decisions concerning the retention and disposition of assets, in order to bring the trust portfolio into compliance with the purposes, terms, distribution requirements, and other circumstances of the trust, and with the requirements of this [Act].”

- UNIF. PRUDENT INVESTOR ACT § 4.
- Trust instrument may modify which assets may be retained, but trustee still has the duty to determine if divestment is advisable under the circumstances.

DUTY OF CARE—PRUDENT INVESTMENT

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

- UNIF. PRUDENT INVESTOR ACT § 2(a).
- Older law considered only certain investments (e.g., blue-chip stocks, AAA bonds) to be “prudent investments.”

DUTY OF CARE—PRUDENT INVESTMENT

- The Uniform Prudent Investor Act enacts *modern portfolio management theory*:
 - Risk is measured not investment by investment, but over the entire portfolio.
 - A trust can hold risky investments as part of a balanced, diversified portfolio.

“A trustee’s investment and management decisions respecting individual assets must be evaluated not in isolation but in the context of the trust portfolio as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the trust.”

- UNIF. PRUDENT INVESTOR ACT § 2(b).

DUTY OF CARE—PRUDENT INVESTMENT

- Among circumstances that a trustee shall consider in investing and managing trust assets are such of the following as are relevant to the trust or its beneficiaries:
 - General economic conditions;
 - The possible effect of inflation or deflation;
 - The expected tax consequences of investment decisions or strategies;
 - The role that each investment or course of action plays within the overall trust portfolio, which may include financial assets, interests in closely held enterprises, tangible and intangible personal property, and real property;
 - The expected total return from income and the appreciation of capital;
 - Other resources of the beneficiaries;
 - Needs for liquidity, regularity of income, and preservation or appreciation of capital; and
 - An asset's special relationship or value to the trust's purposes or the beneficiaries.

DUTY OF CARE—DIVERSIFICATION

“A trustee shall diversify the investments of the trust unless the trustee reasonably determines that, because of special circumstances, the purposes of the trust are better served without diversifying.”

- UNIF. PRUDENT INVESTOR ACT § 3.

"Diversification reduces risk ... [because] stock price movements are not uniform. They are imperfectly correlated. This means that if one holds a well diversified portfolio, the gains in one investment will cancel out the losses in another."

- JONATHAN R. MACEY, AN INTRODUCTION TO MODERN FINANCIAL THEORY 20 (ACTEC Foundation, 1991).

- Diversification can be achieved through:
 - Investment in well-selected securities of different industries, countries, and capitalization.
 - Investment in diversified mutual funds.
 - Investment in corporate fiduciary's common trust fund.

DUTY OF CARE—PROFESSIONAL TRUSTEES

- Corporate trustees will generally be held to a higher standard than individual trustees.

“A trustee who has special skills or expertise, or is named trustee in reliance upon the trustee’s representation that the trustee has special skills or expertise, has a duty to use those special skills or expertise.”

- UNIF. PRUDENT INVESTOR ACT § 2(f).

“[I]f the trustee has or procures his appointment as trustee by representing that he has greater skill than that of a man of ordinary prudence, he is under a duty to exercise such skill.”

- RESTATEMENT (SECOND) OF TRUSTS § 174 (1959).

- Corporate trustees may be held to an even higher standard than the average corporate trustee if they hold themselves out as experts with particular assets, e.g., managing mineral interests or closely held businesses.
- A corporate trustee’s marketing literature may get it into trouble.

DUTY OF CARE—COSTS

“In investing and managing trust assets, a trustee may only incur costs that are appropriate and reasonable in relation to the assets, the purposes of the trust, and the skills of the trustee.”

- UNIF. PRUDENT INVESTOR ACT § 7.
- A trustee should not spend money on things that are unrelated to the trust assets, or that provide little value in relationship to the amount spent.
- In deciding whether and how to delegate, the trustee must balance the projected benefits against the likely costs, and avoid "double dipping.”
- For example, a trustee should not be paid for investment management if it delegates the management to an outside investment advisor.

DUTY OF FULL DISCLOSURE

“The trustee is under a duty to the beneficiary to give him upon his request at reasonable times complete and accurate information as to the nature and amount of the trust property, and to permit him or a person duly authorized by him to inspect the subject matter of the trust and the accounts and vouchers and other documents relating to the trust.”

- RESTATEMENT (SECOND) OF TRUSTS § 173 (1959).

“As trustees ..., [trustees] owed [beneficiary] a fiduciary duty of full disclosure of all material facts known to them that might affect [beneficiary’s] rights. The existence of strained relations between the parties [does] not lessen the fiduciary’s duty of full and complete disclosure.”

- *Montgomery v. Kennedy*, 669 S.W.2d 309, 313 (Tex. 1984) (internal citations omitted).

DUTY OF FULL DISCLOSURE

“A trustee shall keep the qualified beneficiaries of the trust reasonably informed about the administration of the trust and of the material facts necessary for them to protect their interests. Unless unreasonable under the circumstances, a trustee shall promptly respond to a beneficiary’s request for information related to the administration of the trust.”

- UNIFORM TRUST CODE § 813(a).

“The terms of a trust may not limit any common-law duty to keep a beneficiary of an irrevocable trust who is 25 years of age or older informed at any time during which the beneficiary:

(1) is entitled or permitted to receive distributions from the trust; or

(2) would receive a distribution from the trust if the trust were terminated.”

- TEX. TRUST CODE § 111.0035(d).

DUTY OF FULL DISCLOSURE

- Duty to maintain adequate books and records.
 - Starting property of trust.
 - List of all current assets and liabilities of trust.
 - Ledger of all receipts and disbursements, segregated by income and principal.
 - Backup documents (receipts, canceled checks, etc.) for all transactions.
 - Must keep sufficient records to account to beneficiary with backup.
- Duty to make periodic accountings.
 - As set forth in trust instrument or statute, or at beneficiary request.
- Duty to disclose material, non-routine transactions.
 - Disclosure in advance, so beneficiary can object.
 - Disclosure required even if relations are strained or litigation is ongoing.
 - Disclosure even if (especially if!) transaction is a breach of trustee's duty.
- Duty not to commingle trust assets with assets of trustee or third party.

ACCOUNTING REQUIREMENTS

- Uniform Trust Code
 - When required:
 - At least annually;
 - At trust termination; and
 - When trusteeship is vacated, unless cotrustee in office
 - Report containing:
 - List of the trust property;
 - List of liabilities;
 - List of receipts and disbursements, including source and amount of trustee's compensation; and
 - List of trust assets with market values.
- Texas Trust Code Subch. E
 - Provided on beneficiary demand; beneficiary can compel if not provided in 90 days.
 - Since inception or last accounting.
 - Verified statement containing:
 - List of initial trust property;
 - List of receipts, disbursements, and other transactions, by principal and income;
 - List of property currently being administered;
 - Cash on hand and depository where kept; and
 - List of known liabilities.

BACKUP IS REQUIRED

- The trustee must keep backup documents for each of the trust transactions.
- Beneficiaries can then verify the accounting on a transaction-by-transaction basis.
- Trustees should keep all backup documents at least until trustee has accounted and been judicially discharged or released by beneficiaries.

LESSON #2

Duties Limit Powers

- Powers
 - Power to buy and sell property from the trust.
 - Power to only account to beneficiaries once each year.
 - Power to make distributions solely in trustee's discretion.
 - Power to retain initial trust investments.
 - Power to make speculative investments.
- Duties
 - Duty for self-dealing transactions to be fair to the beneficiary.
 - Duty to inform beneficiaries of material, non-routine transactions.
 - Duty to act in best interest of beneficiaries.
 - Duty to monitor initial investments and sell if prudent.
 - Duty to diversify portfolio of investments.

TRUSTEE DISCRETION

- A trustee never has unlimited discretion; it is always liable for fraud, misconduct, or abuse of discretion.

“The right to challenge a fiduciary's actions is inherent in the fiduciary/beneficiary relationship.”

 - *McLendon v. McLendon*, 862 S.W.2d 662, 679 (Tex. App.—Dallas 1993, writ denied), *disapproved of on other grounds*, *Dallas Mkt. Ctr. Dev. Co. v. Liedeker*, 958 S.W.2d 382 (Tex. 1997).
- An abuse of discretion may result:
 - When the trustee exercises discretionary authority in bad faith.
 - When a trustee acts from an improper though not dishonest motive, such as when the act is undertaken for a purpose other than to further the trust’s purposes.
 - When the trustee, arbitrarily or without knowledge of or inquiry into relevant circumstances, fails to exercise the discretion.
 - When the trustee, even in good faith, exercises a power in a manner inconsistent with the duty of loyalty or the duty of impartiality.
 - When the trustee, in exercising a power, has acted “beyond the bounds of a reasonable judgment.”

EXCULPATORY CLAUSES

- Exculpatory clauses are enforceable and can relieve the trustee of liability for a breach of trust. RESTATEMENT (SECOND) OF TRUSTS § 222 (1959).
- Exceptions:
 - Breaches committed in **bad faith** or **intentionally** or with **reckless indifference** to the interest of the beneficiary.
 - Liability for **profit** which the trustee has derived from a breach of trust.
 - Exculpatory provisions inserted into trust instrument as the result of trustee's **abuse of a fiduciary or confidential relationship** with the settlor.

Exculpatory clauses “are strictly construed, and the trustee is relieved of liability only to the extent to which it is clearly provided he shall be excused.”

- RESTATEMENT (SECOND) OF TRUSTS § 222 cmt. a (1959); *In re Texas Pig Stands, Inc.*, 610 F.3d 937, 944 (5th Cir. 2010); *Jewett v. Capital Nat’l Bank of Austin*, 618 S.W.2d 109, 112 (Tex. Civ. App.—Waco 1981, writ ref’d n.r.e.).

UNIFORM TRUST CODE § 1008

(a) A term of a trust relieving a trustee of liability for breach of trust is unenforceable to the extent that it:

(1) relieves the trustee of liability for breach of trust committed in bad faith or with reckless indifference to the purposes of the trust or the interests of the beneficiaries; or

(2) was inserted as the result of an abuse by the trustee of a fiduciary or confidential relationship to the settlor.

(b) An exculpatory term drafted or caused to be drafted by the trustee is invalid as an abuse of a fiduciary or confidential relationship unless the trustee proves that the exculpatory term is fair under the circumstances and that its existence and contents were adequately communicated to the settlor.

TEXAS TRUST CODE § 114.007

(a) A term of a trust relieving a trustee of liability for breach of trust is unenforceable to the extent that the term relieves a trustee of liability for:

(1) a breach of trust committed:

(A) in bad faith;

(B) intentionally; or

(C) with reckless indifference to the interest of a beneficiary; or

(2) any profit derived by the trustee from a breach of trust.

(b) A term in a trust instrument relieving the trustee of liability for a breach of trust is ineffective to the extent that the term is inserted in the trust instrument as a result of an abuse by the trustee of a fiduciary duty to or confidential relationship with the settlor.

(c) This section applies only to a term of a trust that may otherwise relieve a trustee from liability for a breach of trust. Except as provided in Section 111.0035, this section does not prohibit the settlor, by the terms of the trust, from expressly:

(1) relieving the trustee from a duty or restriction imposed by this subtitle or by common law; or

(2) directing or permitting the trustee to do or not to do an action that would otherwise violate a duty or restriction imposed by this subtitle or by common law.

EXCULPATION V. RELIEF FROM DUTY

Example Exculpatory Clause

“To induce any issue of Grantor serving as a Trustee hereunder to serve and to use his or her best judgment in the administration of the trust without the threat of litigation by the beneficiaries, the Trustee who is an issue of Grantor shall not be liable to any beneficiary for any loss caused by negligence or error of judgment, provided that such acts do not amount to fraud, embezzlement, gross negligence or willful breach of trust; but the terms of this sentence waiving liability for negligence or error of judgment shall not apply if void as a matter of law.”

Example Relief-From-Duty Clause

“The Trustees shall have all of the investment powers granted to a trustee in the Texas Trust Code ... *Provided, however,* any trust created under this Trust shall not be subject to Section 117.005 of the Uniform Prudent Investor Act currently set forth in the Texas Property Code which requires diversification. Consequently, the Trustee may retain whatever assets are transferred to any trust created under this Trust Agreement, except the proceeds of any life insurance policies, and shall be under no duty to sell or convert said property, even if such property is non-productive or speculative.”

LESSON #3

Read the Trust Instrument

The records that a trustee typically has include the files for a particular trust and, for professional trustees, documents that apply to the trust business as a whole.

- In the files of the trust:
 - Trust instrument and analysis.
 - Intake questionnaires (risk tolerance, expenses, need for distributions).
 - Communications with beneficiaries and third parties.
 - Legal files.
 - Investment records.
 - Receipts, vouchers, canceled checks, and other backup.
- Other documents generally used by the trustee:
 - Trustee handbook/policy guide.
 - Trust administration committee minutes.
 - Trust investment committee minutes.
 - “Approved” investment list.
 - General bank and regulatory policies.
 - FFIEC reports.

TRUST TERMS CONTROL

- Terms of the trust are controlling, with limited exceptions. UNIF. TRUST CODE § 105(a); TEX. TRUST CODE § 111.0035(a).
- A trust instrument cannot modify certain legal provisions, including:
 - Trustee's duty to act in good faith in accordance with trust purposes. UNIF. TRUST CODE § 105(b)(2); TEX. TRUST CODE § 111.0035(b)(4)(B).
 - Court power to modify or terminate a trust. UNIF. TRUST CODE § 105(b)(4); TEX. TRUST CODE § 111.0035(b)(5)(A).
 - Court power to require, dispense with, modify, or terminate a bond. UNIF. TRUST CODE § 105(b)(6); TEX. TRUST CODE § 111.0035(b)(5)(D).
 - Court power to adjust or deny trustee's compensation. UNIF. TRUST CODE § 105(b)(7); TEX. TRUST CODE § 111.0035(b)(5)(E).
 - Trustee's duty to respond to beneficiary's demand for accounting. UNIF. TRUST CODE § 105(b)(9); TEX. TRUST CODE § 111.0035(b)(4)(A).

HOW IT CAN GO WRONG

- Trust officer has too many trusts.
- Reliance on trust summary rather than trust instrument.
- Bank mergers result in lost files (especially backup documents).
- Layoffs eliminate institutional knowledge of specific trusts and best practices generally.
- Change of investment philosophy applied wholesale without attention to specific trust requirements, tax consequences, etc.

DEFENDING THE TRUSTEE WITH TRUST ASSETS

Uniform Trust Code

A trustee is entitled to be **reimbursed** out of the trust property, with interest as appropriate, for:

- (1) expenses that were **properly incurred** in the **administration of the trust**; and
- (2) to the extent necessary to **prevent unjust enrichment of the trust**, expenses that were not properly incurred in the administration of the trust.

- UNIFORM TRUST CODE § 709(a).

In a judicial proceeding involving the administration of a trust, the court, as justice and equity may require, may award costs and expenses, including reasonable attorney's fees, to any party, to be paid by another party or from the trust that is the subject of the controversy.

- UNIFORM TRUST CODE § 1004.

Texas Trust Code

A trustee may **discharge or reimburse** himself from trust principal or income or partly from both for:

- (1) advances made for the convenience, benefit, or protection of the trust or its property;
- (2) **expenses incurred while administering or protecting the trust or because of the trustee's holding or owning any of the trust property;** and
- (3) expenses incurred for any action taken under Section 113.025 [concerning environmental liability].

- TEX. TRUST CODE § 114.063(a).

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 § 114.064(a).

DEFENDING THE TRUSTEE WITH TRUST ASSETS

- A trustee is usually entitled to reimbursement for attorneys' fees and expenses for successfully defending an action. UNIFORM TRUST CODE § 709 cmt.
- However, a trustee is not ordinarily entitled to attorneys' fees and expenses if it is determined that the trustee breached the trust. *Id.*
- A court has discretion to award fees and expenses against any party or against the trust estate, regardless of who prevails:

“[W]hether a trustee should be awarded an attorney's fee for defending a suit involving his administration of the trust depends upon equitable considerations, ... that the success or failure of the trustee in the litigation may be a matter to be considered but does not necessarily determine the trustee's right to the fee, and that the trustee's good faith and the reasonableness of his actions are matters to be considered”

- *American Nat'l Bank of Beaumont v. Biggs*, 274 S.W. 2d 209, 222 (Tex. Civ. App.—Beaumont 1954, writ ref'd n.r.e.).

TRUSTEE REIMBURSEMENT DURING LITIGATION

- A trustee with control over the trust assets has the power to reimburse itself for its attorneys' fees during the litigation.
- But the trustee also owes a duty of loyalty to the beneficiaries, which it breaches if it fails to "administer the trust in good faith, in accordance with its terms and purposes and the interests of the beneficiaries."
UNIFORM TRUST CODE § 801.

"In administering a trust, the trustee may incur only costs that are reasonable in relation to the trust property, the purposes of the trust, and the skills of the trustee."

- UNIFORM TRUST CODE § 805.

"[A] trustee has a right to charge the trust for the cost of successfully defending against [suits] by beneficiaries. The better practice may be for a trustee to seek reimbursement after any litigation with beneficiaries concludes, initially retaining counsel with personal funds."

- *Wells Fargo Bank v. Superior Court*, 22 Cal.4th 201, 213 n.4 (2000).

SUCCESSFUL TRUSTEES ALLOWED DEFENSE COSTS

- *In re Couch Trust*, 723 A.2d 376, 384–85 (Del. Ch. 1998) (trustee’s successful defense of attacks on its administration and attempt to remove it as trustee “directly benefit the trust and its beneficiaries”).
- *Estate of Beach*, 15 Cal.3d 623, 644–45 (1975) (executor/trustee entitled to costs of breach-of-fiduciary-duty suit for retaining initial assets, but could not allocate costs solely against shares of suing beneficiaries).
- *Estate of Berthot*, 312 Mont. 366, 379–80 (2002) (trustee entitled to trial and appellate costs for successfully defending removal action).
- 3 SCOTT ON TRUSTS § 188.4 (4th ed. 1988) (where trustee properly defends a proceeding for the benefit of the trust estate, he is justified in incurring reasonable expenses including employing an attorney as long as trustee was not at fault in causing the litigation).

BREACHING TRUSTEE DENIED DEFENSE COSTS

- *Citizens & Southern Nat'l Bank v. Haskins*, 254 Ga. 131, 143(1985) (trustee could not recover attorneys' fees for unsuccessful defense of suit alleging trustee neglected trust and failed to sell bonds when prudent).
- *Allard v. Pac. Nat'l Bank*, 99 Wash. 2d 394, 407, 663 P. 2d 104, 112 (1983) (A "trial court abuses its discretion when it awards attorney fees to a trustee for litigation caused by the trustee's misconduct.").
- *In re Gilmaker's Estate*, 226 Cal. App. 2d 658, 662, 38 Cal. Rptr. 270, 272 (Cal. Ct. App. 2d Dist. 1964) (trustee with "no sound basis" for resisting removal "was not entitled to receive out of the trust estate its expenses of litigation, including attorneys' fees, incurred in defending its untenable and partisan position.").
- *In re Drake's Will*, 195 Minn. 464, 468–69, 263 N.W. 439, 442 (1935) ("To say to a trust beneficiary that, even if he succeeds in having his trustee's account surcharged ... he must nevertheless pay the trustee's attorneys' fees and the trustee's fees for contesting the allowance of such a surcharge, is unreasonable.")

LESSON #4

The TIC and TAC Must Toe the Line

- Trust Administrative Committee (TAC)
 - Handles beneficiary relations.
 - Performs trust intake and setup.
 - Decides amount and frequency of regular distributions.
 - Decides on one-time distributions.
 - Pays expenses.
 - Allocates distributions and expenses to income or principal.
- Trust Investment Committee (TIC)
 - Vets potential investments for risk and potential return, and creates “approved” list.
 - Reviews risk tolerance of trust beneficiaries.
 - Reviews particular trust investments for risk and return to match risk tolerance.
 - Handles investment of special assets (real property, mineral interests, closely held businesses, etc.)

POTENTIAL BREACHES FROM TIC/TAC MISCOMMUNICATION

- TIC invests trust without regard to specific trust provisions.
- TIC invests trust without regard to beneficiary risk tolerance.
- TAC does not inform TIC of special distribution requirements of beneficiaries.
- Sales/marketing take on trusts with assets that TIC cannot invest or lacks expertise investing.

LESSON #5

Process, Not Results

- Breaches are not outcome-dependent.
- Whether a trustee breached its duty does not depend on whether the trust increased or decreased in value.

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

 - TEX. TRUST CODE § 114.001(b).
- So a trustee who acts prudently at the time does not breach its fiduciary duty simply by the trust declining in value. Trustees are not judged in hindsight, and are insurers of the trust’s value.
- Conversely, a trustee can breach its duty by risking trust assets, even if the gamble pays off.

FOCUS ON THE PROCESS

- Questions to determine if a breach occurred:
 - Are the trustee's actions consistent with the terms of the trust instrument?
 - Did the trustee conduct an adequate investigation of the facts before making a decision?
 - Did the trustee follow its own policies and were those policies reasonable?
 - Did the trustee (or a third party) benefit from the decision?
 - Is the trustee's decision fair to all of the beneficiaries (including future beneficiaries)?
 - Were the particular circumstances of each beneficiary taken into account?
 - Were appropriate factors weighed in making the decision?
 - Were the beneficiaries given adequate notice of the transaction?
 - Did the trustee maintain complete records of the transaction?
- Documentation at each step of the process is key.

EXAMPLE—DELEGATION

- Old law:

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

 - RESTATEMENT (SECOND) OF TRUSTS § 171 (1959).
- Old law segregated nondelegable “discretionary” functions from delegable “ministerial” functions. Factors included:
 - Amount of discretion involved.
 - Value and character of property involved.
 - Whether the property is principal or income.
 - Proximity or remoteness of subject matter of the trust.
 - Act’s character as involving professional skill or facilities possessed or not by the trustee.
- Difficult to determine what could be delegated, and unrealistic as to what trustees should reasonably be expected to do themselves.

EXAMPLE—DELEGATION

- New law:

“A trustee has a duty personally to perform the responsibilities of trusteeship except as a prudent person might delegate those responsibilities. In deciding whether, to whom, and in what manner to delegate fiduciary authority in the administration of a trust, and thereafter in supervising agents, the trustee is under a duty to the beneficiaries to exercise fiduciary discretion and to act as a prudent person would act in similar circumstances.”

- RESTATEMENT (THIRD) OF TRUSTS: PRUDENT INVESTOR RULE § 171 (1992).

- Integrated into prudent investor rule:

“[T]he trustee must ... act with prudence in deciding whether and how to delegate to others and in the selection and supervision of agents”

- RESTATEMENT (THIRD) OF TRUSTS: PRUDENT INVESTOR RULE § 227(c) (1992).

TEXAS TRUST CODE § 117.011 (UPIA § 9)

(a) A trustee may delegate investment and management functions that a prudent trustee of comparable skills could properly delegate under the circumstances. The trustee shall exercise reasonable care, skill, and caution in:

(1) selecting an agent;

(2) establishing the scope and terms of the delegation, consistent with the purposes and terms of the trust; and

(3) periodically reviewing the agent's actions in order to monitor the agent's performance and compliance with the terms of the delegation.

(b) In performing a delegated function, an agent owes a duty to the trust to exercise reasonable care to comply with the terms of the delegation.

TEXAS TRUST CODE § 117.011 (UPIA § 9)

(c) A trustee who complies with the requirements of Subsection (a) is not liable to the beneficiaries or to the trust for the decisions or actions of the agent to whom the function was delegated, unless:

(1) the agent is an affiliate of the trustee; or

(2) under the terms of the delegation:

(A) the trustee or a beneficiary of the trust is required to arbitrate disputes with the agent; or

(B) the period for bringing an action by the trustee or a beneficiary of the trust with respect to an agent's actions is shortened from that which is applicable to trustees under the law of this state.

(d) By accepting the delegation of a trust function from the trustee of a trust that is subject to the law of this state, an agent submits to the jurisdiction of the courts of this state.

FACTORS FOR PROPER DELEGATION

- All of this should be documented:
 - Need for delegation:
 - What will the agent do that the trustee cannot do, should not do, or would be less skilled in doing?
 - Does need for delegation outweigh added cost and complication?
 - Care in selecting agent:
 - What are the agent's qualifications?
 - Do the agent's credentials check out?
 - What is the agent's track record?
 - Scope of delegation:
 - Are agent's duties spelled out in detail?
 - Is scope of delegation properly limited?
 - Is compensation reasonable and clear?
 - Monitoring agent:
 - Are there regular reports by agent?
 - Are reports reviewed regularly by trustee?
 - Does trustee have ability and qualifications to review agent's actions?
 - Do actions fit the delegation?