ENFORCING BENEFICIARIES' RIGHTS

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March 11, 2011

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ENFORCING BENEFICIARIES' RIGHTS:

I. INTRODUCTION

Despite the exalted legal position of the estate and trust beneficiary due to the legal duties owed to them by their fiduciaries, these beneficiaries are often David rather than Goliath when it comes to enforcing their rights in connection with estates and trusts. Various factors contribute to this imbalance. The fiduciary holds the assets intended to benefit the beneficiary and the authority over them. The beneficiary typically needs financial assistance and may lack financial management expertise. To provide flexibility, testators and settlors tend to give fiduciaries broad powers and discretion, which the law supports.

In most cases, these plans work extremely well, but when they do not, a beneficiary often faces substantial obstacles in trying to enforce his legal rights. The beneficiary may lack the resources to obtain legal advice, while the trustee can access assets intended for the beneficiary to resist the beneficiary's efforts. This article examines some of the more common circumstances that may affect the rights of an estate or trust beneficiary and explores possible solutions that may avoid the high financial and emotional costs of full-blown fiduciary litigation.

II. ESTATES

A. Initiating Probate

1. Delivery of Will

A will is not effectual until probated. TEX. PROB. CODE §94. A beneficiary under a will has no property rights until the testator dies and the will is admitted to probate. *Hunter v. NCNB Tex. Nat'l Bank*, 857 S.W.2d 722 (Tex.App.–Houston [14th Dist.] 1993, writ denied). If a will is in the possession of a person who has not promptly offered it for probate or is intentionally suppressing it, a beneficiary can compel delivery of the will pursuant to Section 75 of the Texas Probate Code. Section 75 provides as follows:

> Upon receiving notice of the death of a testator, the person having custody of the testator's will shall deliver it to the clerk of the court which has jurisdiction of the estate. On sworn written complaint that any person has the last will of any testator, or any papers belonging to the estate of a testator or intestate, the county judge shall cause said person to be cited by personal service to appear before him and show cause why he should not deliver such will to the court for probate, or why he should not deliver such papers to the executor or administrator.

TEX. PROB. CODE § 75.

If delivery is not made or good cause not shown, the person having custody of the will can be arrested and imprisoned until he delivers the will. If the person refuses to deliver the will, he can also be liable to any aggrieved person for damages sustained.

Before initiating a Section 75 proceeding, in most cases the beneficiary should first send a "Section 75 letter" to the person having possession of the will demanding delivery of the will to the clerk in accordance with Probate Code Section 75. This letter will usually cause the person to come forward with the will. A "Section 75 letter" also may be used to determine the existence of and obtain wills executed by the decedent other than the will offered for probate if a party has reason to believe that another will may be the decedent's last valid will. If it is not known who has possession of any other wills, "Section 75 letters" may be sent to all persons who might have possession, including the decedent's prior attorneys. If a Section 75 proceeding is required and the person cited does not deliver the will to the clerk or appear with the will before the court, unless good cause is shown, the person can be arrested and imprisoned until he delivers the will. Such person also can be liable for damages sustained by any person due to his refusal to deliver the will. TEX. PROB. CODE §75.

If the person who failed to promptly file or

deliver is named as the executor in the will, Section 178(b) of the Probate Code may be used to deny the issuance of letters to him. Under Section 178(b), if a named executor neglects to present the will for probate for a period of 30 days after the death of the testator, and there was no good cause for not presenting the will, then administration with will annexed of the estate of such testator shall be granted, should administration appear necessary. The "good cause" exception was added to the statute in 2007 to avoid the argument that an executor was automatically disqualified if he did not offer a will for probate within 30 days. There is no case law indicating what constitutes "good cause" for this purpose. It is likely to be a low threshold given that even prior to the 2007 amendment, courts generally did not refuse the issuance of letters testamentary solely because an executor did not offer the will for probate for more than 30 days. *Alford v. Alford*, 601 S.W.2d 408, 410 (Tex.Civ.App.–Houston [14th Dist.] 1980, no writ). However, if the named executor had possession of the Will and refused to deliver it until compelled to do so under Section 75, such conduct may not constitute "good cause."

Another method of forcing the will to be offered is to seek appointment as the temporary administrator under Probate Code Section 131A due to the absence of a will. Once the party having possession of the will learns of the appointment of a Temporary Administrator, an application to probate the will is likely to follow quickly.

2. Contest Qualification of Executor

A person designated as executor in the will has a statutory priority to serve. TEX. PROB. CODE §77. *In Re: Estate of Foster*, 3 S.W.3d 49, 54 (Tex.App.–Amarillo 1999, no pet.). The right of a testator to select his own executor is well-established under Texas law. *Kappus v. Kappus,* 284 S.W.3d 831 (Tex. 2009); *Boyles v. Gresham*, 309 S.W.2d 50 (Tex. 1958). However, the named executor may be disqualified. TEX. PROB. CODE §77. If a beneficiary has concerns about the executor named in the will, the possibility of disqualification should be evaluated.

Section 78 of the Probate Code sets forth the following bases for disqualification:

(1) An incapacitated person;
(2) A convicted felon;
(3) A nonresident of Texas who has not appointed a resident agent to accept service of process in actions relating to the estate;
(4) A corporation not authorized to act as a fiduciary in Texas; and
(5) A person whom the court finds unsuitable.

The court has broad discretion in determining whether a person is "unsuitable" and, therefore, disqualified to serve as executor. The court's decision will be reviewed under an abuse of discretion standard. *In re Estate of Boren*, 268 S.W.3d 841 (Tex.App.–Texarkana 2008, pet. denied). *In Re: Estate of Vigen*, 970 S.W.2d 597, 600 (Tex.App.–Corpus Christi 1998, no pet.). An order that a party is disqualified to serve as a personal representative is a final order for purposes of appeal. *Spies v. Milner*, 928 S.W.2d 317 (Tex.App.–Fort Worth 1996, no writ).

"Unsuitability" is not defined in the Probate Code, and the case law has not developed any bright line test. *In Re: Estate of Robinson*, 140 S.W.3d 801 (Tex.App.–Corpus Christi 2004, pet. denied); *Olquin v. Jungman*, 931 S.W.2d 607, 610 (Tex.App.–San Antonio 1996, no writ). Due to the factual nature of the issue, the cases are difficult to synthesize. However, one general rule that seems to have emerged is that a person claiming ownership of property to the exclusion or detriment of the estate is deemed unsuitable because of the conflict of interest between that person and the state, while a person making a claim within the probate process (*i.e.*, claiming under the will or attempting to collect a debt from the estate) is not deemed unsuitable. *In re Estate of Robinson*, 140 S.W.3d at 806; *In re Estate of Foster*, 3 S.W.3d 49, 55 (Tex.App.–Amarillo 1999, pet. denied); *Olquin v. Jungman*, 931 S.W. 2d at 610. *But see* the discussion of *Kappus v. Kappus,* 284 S.W.3d 831, at II.C.1. *infra*.

In the following cases, the courts found the named executor "unsuitable" to serve:

In re Estate of Boren, 268 S.W.3d 841 (Tex.App.–Texarkana 2008, pet. denied) (decedent's nephew unsuitable because as attorney-in-fact for decedent prior to her death, he used funds for his personal benefit)

Haynes v. Clanton, 257 S.W.2d 789, 792 (Tex.Civ.App.--El Paso 1953, writ dism'd by agr.)(administrator was disqualified as "unsuitable" when the bank in which he owned stock claimed certain of the estate's assets as its own property)

Hitt v. Dumitrov, 598 S.W.2d 355, 356 (Tex. Civ.App.–Houston [14th Dist.] 1980, no writ)(individual disqualified from serving as administrator of the estates of both a husband and his wife wherein each estate had adverse claims to the same insurance proceeds)

Ayala v. Martinez, 883 S.W.2d 270, 272 (Tex.App.–Corpus Christi 1994, writ denied)(surviving spouse was found unsuitable because she claimed property of the husband's separate estate as community property)

Formby v. Bradley, 695 S.W.2d 782, 785 (Tex.App.– Tyler 1985, writ ref'd n.r.e.)(surviving wife was unsuitable where her appointment "would be inimical to the interests of the Estate," and "inimical" was defined as adverse, antagonistic, and hostile)

The courts did not find the person "unsuitable" in the following cases:

Boyles v. Gresham, 309 S.W.2d at 54 (good-faith creditor of estate not necessarily unsuitable to serve as administrator but may be found unsuitable when claim against estate is controversial)

In re Foster, 3 S.W.3d at 56 (independent executor named in will not unsuitable as matter of law simply because he has claim against estate)

Olguin v. Jungman, 931 S.W.2d at 609-10 (trustee of charitable remainder trust not unsuitable to serve as independent executor of income beneficiary's estate)

In re Estate of Roots, 596 S.W.2d 240, 244 (Tex.Civ.App. – Amarillo 1980, no writ) (executor's charging or intending to charge excess compensation does not bear on suitability to serve)

The challenge of an individual's suitability to be appointed executor has been held not to fall within the no contest clause. *In Re: Estate of Newbill*, 781 S.W.2d 727, 729 (Tex.Civ.App.–Amarillo 1989, no writ).

3. <u>Family Settlement Agreement</u>

Family settlement agreements are an alternative method of administration in Texas. They are favored by courts, and supported by public policy. *Crossley v. Staley*, 988 S.W.2d 791, 796 (Tex.App.–Amarillo 1999, no writ); *Stringfello v. Early* , 40 S.W. 81 (Tex.Civ.App.–1897, writ dism'd). The beneficiaries of an estate are free to arrange among themselves for the distribution of the estate and for the payment of expenses from that estate. *Shepherd v. Ledford*, 962 S.W.2d 28, 32 (Tex. 1997).

All of the beneficiaries under a will may agree not to probate the will and/or to vary the dispositive terms by settlement of a contest. *Gregory v. Rice,* 678 S.W.2d 603 (Tex.App. – Houston [14th Dist.] 1984). A family settlement also may be used to eliminate any necessity for administration so that the will is probated only as a muniment of title. *Cooper v. Coe*, 188 S.W.3d 223, 227 (Tex.App. – Tyler 2005, pet. denied)(family settlement agreement which governed distribution of estate and payment of estate expenses provided support for the assertion that no necessity of the administration fo the estate was necessary); *Estate of Hodges,* 725 S.W.2d at 269 (the existence of a family settlement agreement that provides for the division of the estate, payment of estate creditors, and the transaction of estate business may obviate the need for administration).

An independent executor who is not a beneficiary under the will does not have standing to object to a family settlement agreement. *Estate of*

Hodges, 725 S.W.2d 265 (Tex.App.–Amarillo 1986, writ ref'd n.r.e.). In fact, an independent executor's challenge to a court approved settlement agreement can amount to tortious interference with the beneficiaries' rights. *Hartmann v. Solbrig*, 12 S.W.3d 587 (Tex.App.–San Antonio 2000, writ denied).

4. Temporary Administration

The appointment of a temporary administrator may be necessary pending resolution of the qualification dispute. A temporary administrator may provide several important advantages. The temporary administrator will protect and preserve the assets during the dispute. A temporary administration prevents any of the parties from having access to estate assets to fund their side of the case. The temporary administration often eliminates, or greatly diminishes, the role of the executor, thus limiting its appeal. Depending on the duration of the dispute, the temporary administrator may have completed much of the estate administration. All of these factors create an opportunity for a relatively early and cost effective resolution. In fact, the parties may be able to fashion a Family Settlement Agreement that provides for the temporary administrator to pay the debts and expenses and distribute the estate assets directly to the beneficiaries upon closing the temporary administration and avoid the need for a permanent administration. The price paid (literally) is the cost of the temporary administration. Although the cost can be significant, it may an economic trade off by limiting the costs of the dispute.

A temporary administrator may be appointed either before a will is offered for probate under Probate Code Section 131A or after a will has been offered for probate but before it has been probated under Probate Code Section 132. Each has different requirements.

Under Section 131A, the court may appoint a temporary administrator if the court determines that the interest of the estate requires the immediate appointment of a personal representative. The temporary administrator is to be granted only limited powers as the circumstances require. The appointment may not last more than 180 days. The temporary administrator must be bonded. A temporary administrator may be appointed pending resolution of the disqualification dispute. The temporary administrator may be appointed under Section 131A without notice. After the temporary administrator qualifies, the county clerk will issue posted notice of the appointment to all interested persons. The temporary administrator also is required to immediately notify the known heirs of the decedent of his appointment by certified mail, return receipt requested. An interested person may request a hearing to contest the appointment within fifteen days after the date letters of appointment are issued.

Under Probate Code Section 132, the court may appoint a temporary administrator during the pendency of a contest to the probate of a will or to the granting of letters of administration. The appointment under this section may continue until the termination of the contest. The court may confirm upon the temporary administrator all of the power and authority of a permanent administrator with respect to claims against the estate. A temporary administrator, under either section, may be appointed only if there is not already an existing personal representative with full powers. *Corpus Christi Bank & Trust v. Alice National Bank,* 444 S.W.2d 632, 637 (Tex. 1969); King *v. King,* 230 S.W.2d 335 (Tex.Civ.App. – Amarillo 1950, writ ref'd) Once an executor or administrator has been appointed in an estate, such person will continue to serve unless removed under the Texas Probate Code. See TEX. PROB. CODE §149C for removal of independent executors discussed at II.C.1. *infra*.

B. Estate Administration

1. Inventory

An executor is required to file an Inventory, Appraisement and List of Claims within 90 days after qualification, unless extended by court order. TEX. PROB. CODE §§250, 251. These sections apply to independent executors, as well as dependent representatives. TEX. PROB. CODE §145(h). The Inventory lists all of the property of the estate at the fair market value at date of death and classifies the property as either separate or

community. An independent executor may be removed for failing to timely file an inventory. TEX. PROB. CODE §§149C(a)(1); 260.

A beneficiary may file objections to the Inventory and cause the executor to be cited to appear before the court and show cause why the errors should not be corrected. TEX. PROB. CODE §258. If the court finds that the inventory is erroneous or unjust, the court will order the executor to correct the inventory or will appoint appraisers to make a new appraisement of any item. *Id.* An order approving or modifying the Inventory is appealable. *Anderson v. Anderson,* 535 S.W.2d 943 (Tex.Civ.App. – Waco 1976, no writ).

An order approving an inventory does not adjudicate title to the estate's property, but it is prima facie evidence of ownership. TEX. PROB. CODE §261; *Adams v. Sandler,* 696 S.W.2d 690 (Tex.App. – Austin 1985, writ ref'd n.r.e.)(order of probate court approving corrected inventory that property was part of trust estate and not guardianship estate was proper, but did not adjudicate title to the property); *McKinley v. McKinley,* 496 S.W.2d 540, 542 (Tex. 1973). Nevertheless, filing objections to an inventory that contradicts your client's position is advisable to avoid unexpected disputes, including claims of waiver or estoppel.

Query: If an approved Inventory listing property as the decedent's separate property constitutes prima facie evidence, does the inventory reverse the community property presumption?

In practice, many courts approve the Inventory on the day it is filed. If a beneficiary anticipates property disputes, the beneficiary may want to make a written request to the independent executor to provide prior written notice of the executor's intention to file the inventory and give the beneficiary time to review it before submitting an order to the court approving it.

Once the Inventory has been filed by the independent executor and approved by the court, "further action of any nature shall not be had in the county court except where this Code specifically and explicitly provides for some action in the county court." TEX. PROB. CODE §145(h).

2. <u>Accounting from Independent Executor</u>

A beneficiary may demand an accounting of an estate from the independent executor after the expiration of fifteen months from the date of the executor's appointment. TEX. PROB. CODE §149A. The independent executor must furnish a sworn accounting setting forth "in detail" the following:

a. The property belonging to the estate which has come into his hands as executor.

b. The disposition that has been made of such property.

c. The debts that have been paid.

d. The debts and expenses, if any, still owing by the estate.

e. The property of the estate, if any, still remaining in his hands.

f. Such other facts as may be necessary to a full and definite understanding of the exact condition of the estate.

g. Such facts, if any, that show why the administration should not be closed and the estate distributed.

TEX. PROB. CODE §149A(a).

If the independent executor does not comply with a demand for an accounting within 60 days after receipt of the demand, the person making the demand may compel compliance by an action in court. After a hearing, the court shall enter an order requiring the accounting to be made at such time as the court deems proper under the circumstances. TEX. PROB. CODE

Subsequent accountings may be demanded only for twelve-month intervals. TEX. PROB. CODE §149A(c). A beneficiary has four years from the time that the estate is closed to demand an accounting from the independent executor. *Estate*

of McGarr, 10 S.W.3d 373 (Tex.App. – Corpus Christi 2000, writ denied); *Little v. Smith,* 943 S.W.2d 414, 416 (Tex. 1997).

3. Disclosure Prior to 15 Months

One of the negative aspects of an independent administration is that a beneficiary has no statutory right to obtain any information regarding the estate administration before the expiration of 15 months. A great deal of damage could be done to the estate during such a long period of time during which the independent executor does not have to formally account to anyone.

Although the law is not clear, it would appear that an estate beneficiary should be entitled to some information regarding the estate within the first 15 months. The executor is required to gather the estate assets, pay claims and debts of the estate, and hold the property "in trust" for proper distribution. TEX. PROB. CODE §37; *Bailey v. Cherokee County Appraisal District,* 862 S.W.2d 581, 584 (Tex. 1993). As trustee of the estates property, the executor is held to the same fiduciary standards that apply to all trustees. *Humane Society of Austin & Travis County v. Austin Nat'l Bank,* 531 S.W.2d 574 (Tex. 1975), cert. denied, 425 U.S. 976 (1976). These fiduciary duties include the duty of full disclosure to the beneficiaries of all material facts that effect their rights. *See Huie v. DeShazo, 922 S.W.2d 920 (Tex. 1996)*; *In re Peterson,* 2004 WL 88872 (Tex.App.-Amarillo) (not designated for publication).

In *Peterson*, the Amarillo Court of Appeals approved the probate court's order directing the independent executor to provide the estate tax return to the beneficiaries. The court stated that "the parties before us are not simply litigants in an ordinary suit. Rather, they are parties to a fiduciary relationship." As such, the executor is obligated to disclose all material facts that might affect their rights. The tax return was material and contained information that could affect the rights of the beneficiaries. By analogy to trust cases, estate beneficiaries should be entitled on a reasonable basis to inspect the books and records of the estate or other relevant documents. *See* III.A.4.a. *infra*.

4. Accounting from Agent Under POA

Section 489B of the Texas Probate Code provides that an agent under a power of attorney is a fiduciary and has a duty to inform and to account for actions taken pursuant to the power of attorney. The agent is required to maintain records of each action taken or decision made by him or her. The principal, or his ***personal representative***, may demand an accounting by the agent. The accounting shall include:

a. the property belonging to the principal that has come to the agent's knowledge or into the agent's possession;

b. all actions taken or decisions made by the agent;

c. a complete account of receipts, disbursements, and other actions of the agent, including their source and nature, with receipts of principal and income shown separately;

d. a listing of all property over which the agent has exercised control, with an adequate description of each asset and its current value if known to the agent;

e. the cash balance on hand and the name and location of the depository where the balance is kept;

f. all known liabilities; and

g. such other information and facts known to the agent as may be necessary to a full and definite understanding of the exact condition of the property belonging to the principal.

TEX. PROB. CODE §489B(c), (d). The agent is required to maintain all records regarding the principal's property until delivered to the principal or discharged by a court. TEX. PROB. CODE §489B(e), (f). If the agent fails or refuses to provide documentation or deliver the accounting within 60 days, the principal may file suit to compel the agent to deliver the accounting, or to deliver the assets. TEX. PROB. CODE §489B(g). If the principal

is deceased, the principal's personal representative shall have all authority to act as given to the principal.

While the general rule is that only the executor may bring actions on behalf of the estate, there are exceptions to this rule. If the executor will not or can not act, or if his interest is antagonistic to that of the beneficiaries, the beneficiaries may bring an action. *Chandler v. Welbourn*, 294 S.W.2d 801 (Tex. 1956). Thus, if the independent executor was also the agent under the decedent's power of attorney, and there are questions or concerns regarding his actions as agent, the beneficiaries of the estate should be entitled to step into the shoes of the principal to seek an accounting from the agent.

5. Distributions

a. Assets

Any time after the expiration of two years from the date that an independent administration is created and the order appointing the independent executor was entered, a beneficiary of an estate may petition the court for and accounting a distribution of the estate. TEX. PROB. CODE 149B(a).

Upon receipt of the accounting, unless the court finds a continued necessity for administration of the estate, the court shall order its distribution by the independent executor to the beneficiary. TEX. PROB. CODE §149B(b). However, if the court finds that there is a continued necessity for administration of the estate, the court shall order the distribution of any portion of the estate that the court finds is not subject to further administration. *Id.* If any portion of the estate ordered distributed is incapable of distribution without prior partition or sale, the court shall order partition and distribution or sale. Id. If all of the property of the estate is distributed, the court may order the independent executor to file a final account with the court and may enter an order closing the administration and terminating the power of the independent executor to act as executor. TEX. PROB. CODE § 149B(c).

b. Estate Income

Both the Probate Code and the Trust Code provide rules for determining income during the administration of a decedent's estate. TEX. PROB. CODE §378(B); TEX. TRUST CODE §116.051, 116.052. The rules provided in the Trust Code sections also apply to a determination of income after an income interest in a trust ends. The Trust Code provisions prevail to the extent of any conflict between those sections and Probate Code §378(B). TEX. PROB. CODE §378(B)(I). These statutes provide the following general rules:

(1) The terms of the will control. The statutory rules are default rules. TEX. PROB. CODE §378(B)(a).

(2) Debts, funeral expenses, estate taxes, penalties relating to estate taxes, and family allowances, and all other expenses incurred "in connection with the settlement of a decedent's estate" are charged against the principal of the estate. TEX. PROB. CODE §378(B)(a).

(3) Attorney's fees, accounting fees, professional advisor fees, commissions and expenses of a personal representative, court costs and all other similar fees or expenses "relating to the administration of the estate" and interest relating to estate taxes are allocated between the income and principal of the estate as the executor determines in its discretion to be just and equitable. TEX. PROB. CODE §378(B)(a).

(4) Income from the assets of a decedent's estate that accrues after date of death and before distribution, including income from property used to discharge liabilities, is to be determined under the rules provided in Chapter116 of the Texas Trust Code. TEX. PROB. CODE §378(B)(b).

(5) The net income from property specifically bequeathed or devised is distributed to the specific devisee. Property taxes, ordinary repairs, insurance premiums, interest accrued after death, other expenses of management and operation of the property, and other taxes, including taxes imposed on the income that accrues during the period of administration, are payable out

of the income from the property. TEX. PROB. CODE §378(B)(c).

(6) All other estate income is distributed to the other devisees after reduction for the balance of property taxes, ordinary repairs, insurance premium, interest accrued, other expenses of management and operation of all property from which the estate is entitled to income, and taxes imposed on income that accrues during the period of administration and that is payable or allocable to the devisees, in proportion to the devisees' respective interests in the undistributed assets of the estate. TEX. PROB. CODE §378(B)(d).

(7) Any estate income that is distributed to a trustee under a will is treated as income of the trust as provided by Texas Trust Code §116.101. TEX. PROB. CODE §378B(g).

(8) Chapter 116 of the Texas Trust Code prevails to the extent there is any conflict between Probate Code §378B and Chapter 116 of the Trust Code. TEX. PROB. CODE §378(B)(i).

(9) A beneficiary who receives a pecuniary bequest is entitled to interest on such amount at the legal rate of interest provided by Section 302.002 of the Finance Code beginning one year after the decedent's date of death until the pecuniary bequest is distributed. TEX. TRUST CODE §116.051(3).

(10) A beneficiary of a trust that is a beneficiary of a decedent's estate is entitled to net income from the date of the decedent's death, even if there is an intervening period of administration of the testator's estate. TEX. TRUST CODE §116.101(b)(2).

Proper application of these rules is necessary to determine the proper amount of income from the estate to which a beneficiary is entitled, either outright or through a trust. A beneficiary's share of income can be substantially different from the beneficiary's residuary percentage share of financial accounting income or taxable income. Most substantial payments from an estate are chargeable to principal under the Probate Code and Trust Code and thus would not usually reduce a residuary beneficiary's income. Any charges against estate income will require the exercise of the executor's discretion and be subject to challenge. If the will contains a common provision providing for payment of all debts, expenses of administration, taxes and funeral expenses to be paid out of the residuary estate, those amounts would be chargeable to principal.

These rules can have a dramatic impact on the amount of income payable to an income beneficiary of a trust that receives property from an estate. Under the allocation rules, most of the gross of the estate from date of death until distribution will be characterized as income. Although the underlying bequest (principal) will be reduced by disbursements, which will reduce the income beneficiary's future income, the reduction will likely be much smaller than it would be if the expenses are paid out of income.

Trust Code 116.102 provides for the allocation of receipts or disbursements to principal if the due date occurs before the date of death or is not periodic, and to income if after. If there is no specific due date, the item is treated as accruing from day to day. The amount allocated pre-death is principal, and the amount allocated post-death is income. If the due date is periodic, any payment due before date of death but unpaid at date of death is allocated to principal and any payment due after is allocated to income. Examples of periodic receipts are lease payments and interest.

6. <u>Right to Estate Property In Kind</u>

Probate Code Section 37 provides that title to the testator's property vests immediately in the beneficiaries at the moment of death, subject to the administration. *Smith v. Hodges*, 294 S.W.3d 774, 777 (Tex.App.-Eastland 2009, no writ); *Laas v. Seidel*, 95 Tex. 442, 67 S.W. 1015 (1902); *Freeman v. Banks*, 91 S.W.2d 1078 (Tex.Civ.App.-Fort Worth 1936, writ ref'd). Upon the issuance of letters testamentary, the executor shall have the

right to possession of the estate as it existed at the death of the testator and shall hold such estate in trust to be disposed of in accordance with the law. Interestingly, Section 37 changed the common law rule with respect to real property, which at common law passed to the heirs or devisees and was not subject to estate administration. *Sinnott v. Gidney,* 322 S.W.2d 507 (Tex. 1959)).

An independent executor has authority to estate property only for the purpose of paying debts, expenses of administration, funeral expenses, and expenses of last illness, even if the will does not provide such authorization. TEX. PROB. CODE §§145(h); *Smith v. Hodges*, 294 S.W.3d 774, 778 (Tex.App.-Eastland 2009, no writ); *Lesikar v. Rappeport,* 809 S.W.2d 246, 251 (Tex.App.-Texarkana 1991, no writ); *Broadmoor II,* 635 S.W.2d 572, 576 (Tex.App.-Dallas 1982, writ ref'd); *Buckner Orphans Home v. Maben,* 252 S.W.2d 726 (Tex.Civ.App.-Eastland 1952, no writ); *Freeman v. Banks*, 91 S.W.2d 1078, 1080 (Tex.Civ.App.-Fort Worth 1936, writ ref'd). Probate Code Sections 331 and 334 do not apply to independent executors. *Smith v. Hodges*, 294 S.W.3d 774, 778 (Tex.App.-Eastland 2009, no writ).

Absent specific authority in the will, and independent executor cannot sell property that is incapable of being fairly partitioned among the beneficiaries without a court order pursuant to Probate Code Section 150. *Smith v. Hodges*, 294 S.W.3d 774, 778 (Tex.App.-Eastland 2009, no writ); *Clark v. Posey,* 329 S.W.2d 516, 518-19 (Tex.Civ.App.-Austin 1959, writ ref'd n.r.e.).

Even if the will expressly grants the independent executor the power to sell and/or partition estate property, the executor must do so in accordance with his fiduciary duties. He cannot act arbitrarily. Thus, unless there is a reasonable necessity to sell estate property or all of the beneficiaries consent to the sale, selling estate assets may constitute a breach of the executor's fiduciary duties, particularly over the objections of any beneficiary.

7. Declaratory Judgment

A beneficiary may file a declaratory judgment action to resolve disputes regarding estate issues. Texas Civil Practices and Remedies Code Section 37.005 provides that a beneficiary of a trust or an estate may seek a declaration of rights or legal relations regarding the trust or estate:

a. to ascertain any class of creditors, devisees, legatees, heirs, next of kin or others;

b. to direct the executors, administrators or trustees to do or abstain from doing any particular act in their fiduciary capacity;

c. to determine any questions arising in the administration of the trust or estate, including questions of construction of wills and other writings; or

d. to determine rights or legal relations of an independent executor or independent administrator regarding fiduciary fees in the settling of accounts.

A declaratory judgment may be sought in an independent administration, provided it is not a disguised attempt to obtain court supervision over the independent executor's actions in violation of Probate Code Section 145(h). *Estate of Bean*, 120 S.W.3d 914 (Tex.App.–Texarkana 2003, writ denied) (appointment of independent executor did not deprive trial court of jurisdiction to construe will under Declaratory Judgment Act); *Estate of Kuenstler v. Trevino*, 836 S.W.2d 715 (Tex.App.–San Antonio 1992, no writ)(statutory probate court had jurisdiction over independent executor to render declaratory judgment concerning debt owed by estate).

8. Closing the Estate

a. By Independent Executor

Pursuant to Section 151 of the Texas Probate Code, an independent executor may close an estate by filing a final account verified by affidavit. TEX. PROB. CODE § 151. The filing of such affidavit and proof of its delivery terminates the administration and the power and authority of

the independent executor. However, it does not relieve the independent executor from liability for any false statements contained in the affidavit or any liability for the mismanagement of the estate. Alternatively, an independent administration is considered closed when the debts have been paid to the extent of available assets and all property has been distributed. *Little*, 943 S.W.2d at 416, 423.

b. By Beneficiary

A beneficiary of an estate is entitled to have an independent administration closed and have his property distributed to him. *See Lesikar v. Rappeport*, 809 S.W.2d 256, 251, 252 (Tex.App.–Texarkana 1991, no writ). Section 152 of the Texas Probate Code allows the beneficiary of the estate to require a closing of the estate where the independent executor fails to do so. TEX. PROB. CODE § 152 . This section allows the beneficiary to file an application to close the administration at any time after the estate has been fully administered and there is no further need for administration and obtain a court order directing the independent executor to file the closing affidavit required by Section 151(a). The Probate Code provides for the legal effect of the closing affidavit. The closing affidavit:

> shall constitute sufficient legal authority to all persons owing any money, having custody of any property, or acting as registrar or transfer agent or trustee of any evidence of interest, indebtedness, property, or right that belongs to the estate, for payment or transfer without additional administration to the persons described in the will as entitled to receive the particular asset or who as heirs at law are entitled to receive the asset.

TEX. PROB. CODE §151(c); 152(b). Accordingly, the beneficiaries should be able to obtain property directly from anyone holding any assets belonging to the estate without the involvement of a personal representative. If any party holding estate assets refuses to turn over the property, the beneficiaries "may enforce their right to the payment or transfer by suit." *Id.*

c. No Release Required

An independent executor may not demand a waiver or release from a beneficiary as a condition of delivery of property to which the beneficiary is entitled. TEX. PROB. CODE § 151(d). If the independent executor decides to file a final account to seek a judicial discharge under Probate Code Section 149E, the independent executor must first distribute all remaining assets to the beneficiaries, except for a reasonable reserve pending court approval of the final account. TEX. PROB. CODE § 149D.

C. Runaway Executor

1. Removal

A beneficiary may seek removal of an independent executor under Probate Code Section 149C. Section 149C provides the following grounds for removal:

> (1) the independent executor fails to return within ninety days after qualification, unless such time is extended by order of the court, an inventory of the property of the estate and list of claims that have come to the independent executor's knowledge;
>
> (2) sufficient grounds appear to support belief that the independent executor has misapplied or embezzled, or that the independent executor is about to misapply or embezzle, all or any part of the property committed to the independent executor's care;
>
> (3) the independent executor fails to make an accounting which is required by law to be made;
>
> (4) the independent executor fails to

> timely file the affidavit or certificate required by Section 128A of this code;
>
> (5) the independent executor is proved to have been guilty of gross misconduct or gross mismanagement in the performance of the independent executor's duties; or
>
> (6) the independent executor becomes an incapacitated person, or is sentenced to the penitentiary, or from any other cause becomes legally incapacitated from properly performing the independent executor's fiduciary duties.

TEX. PROB. CODE § 149C. Removal of the executor is not mandatory upon proof of statutory grounds for removal, and the order is reviewed under an abuse of discretion standard. *Lee v. Lee*, 47 S.W.3d 767 (Tex.App.–Houston [14th Dist.] 2001, writ denied). An independent executor must be personally served with citation in a removal action, and service on the executor's attorney is insufficient. *Cunningham v. Parkdale Bank*, 660 S.W.2d 810 (Tex. 1983).

The Texas Supreme Court's recent opinion in *Kappus v. Kappus,* 284 S.W.3d 831 (Tex. 2009), provides guidelines for the interpretation of Section 149C. Refusing to engraft conflict of interest onto Section 149C as a ground for removal, the Court concluded that a good-faith disagreement between and executor and the estate over the percentage, division and valuation of estate assets is not grounds for removal as a matter of law. *Id at 838.* James ("Decedent") and John (the "Executor") were brothers and had acquired land as equal co-tenants. In a divorce between James and his wife, Sandra, Sandra acquired an equitable lien on James' share of the property for her one-half of the community improvements made to the property. James died in 2005. John was appointed as executor under his will. John was in the process of selling the land in order to pay the Decedent's debts. Sandra, on behalf of her children, objected to the sale, claiming that James' estate owned more than fifty percent (50%) of the land due to improvements James had made. Sandra also sought to remove John as the independent executor and as the trustee of a testamentary trust based on conflict of interest. The trial court divided the property 58.59% for the estate and 41.41% for John and refused to remove John. The Austin Court of Appeals reversed the trial court's decision on removal, finding that John's conflict of interest required removal under Section 149C.

The Texas Supreme Court reversed the Court of Appeals and held that removal of John as the independent executor was improper under Section 149C. The court analyzed Sandra's claim for removal based on subsections (2) ("misapplied or embezzled"), (5) ("gross misconduct or gross mismanagement"), and (6) ("legally incapacitated) of Section 149C.

The court gave the terms "misapplied or embezzled" used in subsection (2) "a related meaning and interpreted them to authorize removal if the trial court believes the executor was engaged in subterfuge or wrongful misuse." *Id.* at 830. The court found that the evidence showed, at worst, a good-faith disagreement between John and Sandra as to how to split the value of the improvements between John and the estate. There was no evidence of dishonesty or misappropriation by John.

The court interpreted the terms "gross misconduct or gross mismanagement" to mean "something beyond ordinary misconduct and ordinary mismanagement." *Id.* The court defined "gross" as "glaringly obvious; flagrant," according to the American Heritage College Dictionary. The court held that a conflict of interest is not per say "gross misconduct or gross mismanagement," noting that the Probate Code allows creditors of an estate to serve as administrator despite their conflict of interest by virtue of a claim against estate assets. The court expressed concern that by "declaring a per say removal rule for 'conflict of interest' whenever spouse-executors have a shared interest in

community property, and issues arise over the separate or community character of the estate assets, the surviving spouse could be ousted." In addition, such a rule "would undermine the ability of Texas testators to name their own independent executor and also weaken the ability of a executor 'free of judicial supervision,' to effect the distribution of an estate with a minimum of cost and delay." Further, it would impose "this extra-statutory restriction even if the testator was fully aware of the potential conflict when the executor was chosen." The court held that a good-faith disagreement over the executor's ownership share in the estate does not, standing alone, equate to actual misconduct.

The Court did recognize, however, that "there may be scenarios where an executor's conflict of interest is so absolute as to constitute what the statute terms "gross misconduct or gross mismanagement," and listed the following factors to be considered in making that determination:

> (1) the size of the estate,
>
> (2) the degree of actual harm to the estate,
>
> (3) the executor's good-faith in asserting a claim for estate property,
>
> (4) the testator's knowledge of the conflict, and
>
> (5) the executor's disclosure of the conflict.

Id. at 837-838. As support for factor (4), the court cited *In re Roy,* 249 S.W.3d 592, 596-97 (Tex.App. – Waco 2008, pet. denied), which held that while a conflict of interest might not be enough to remove an independent executor, the failure to disclose that conduct was grounds for removal.

The court found that all of the factors favored John and affirmed the trial court's decision not to remove John for gross misconduct or gross mismanagement. *Id.* at 838.

The final argument made by Sandra was that John was "legally incapacitated" from performing as independent executor due to his conflict of interest. The Court held that subsection (6) is "inapplicable to an alleged conflict of interest." The court defined an incapacitated person as a "person who is impaired by an intoxicant, by mental illness or deficiency, or by physical illness or disability to the extent that personal decision-making is impossible." Citing Black's Law Dictionary 775 (8th ed. 2004). *Id.*

The Court also affirmed the trial court's decision not to remove John as trustee of the testamentary trust. Although recognizing that Trust Code Section 113.082 governing removal of a trustee provides "more leeway on removal" than does the Probate Code because a court may a trustee for 'other cause," the Court applied essentially the same analysis as it did to the Probate Code removal statute. The Court concluded with three policy reasons for its decision that a good-faith disagreement between the executor and the estate in this case was not grounds for removal. The court stated that such a development would:

> (1) depart from the specific grounds for removal in the statute,
>
> (2) frustrate the testator's choice of executor (particularly the common practice of appointing spouse-executors), and
>
> (3) impede the broader goal of supporting the independent administration of estates with minimal costs and court supervision.

It should be noted that the Court specifically distinguished the grounds for removal of an executor post-appointment from those to disqualify a person to serve as executor pre-appointment under Probate Code Section 78. The Court found that the power under Section 78 to find a person

"unsuitable" confers much broader court discretion than Section 149C. This distinction indicates that certain types of conflicts of interests may provide a basis for finding a person "unsuitable" to serve. *See* I.A.2. *supra*

The concerns discussed in *Kappus* are consistent with those discussed in *Geeslin v. McElhenney,* 788 S.W.2d 683, 684 (Tex.App. – Austin 1990, no writ). In *Geeslin,* the Austin Court of Appeals declined to interpret the terms "gross mismanagement and gross misconduct" to encompass any and all deviations from ordinary care because such an interpretation "would practically convert independent administration into court-supervised administration, by encouraging numerous lawsuits challenging almost every aspect of an executor's conduct regarding the estate."

Removal of an independent executor was affirmed in *Estate of Miller,* 243 S.W.3d 831 (Tex.App. – Dallas, no writ), where the attorney-independent executor, who was the great nephew of the 101 year old decedent filed an Inventory 19 months after appointment, paid himself exorbitant and unnecessary attorneys fees, failed to pay property taxes or correct code violations leaving the estate property subject to foreclosure, and made a loan to client with no repayment terms, interest or collateral.

An independent executor who defends an action for his removal in good faith, whether successful or not, shall be allowed out of the estate his necessary expenses and disbursements, including reasonable attorney's fees, in the removal proceedings. TEX. PROB. CODE § 149C(c) ; *Hartmann v. Solbrig,* 12 S.W.3d 587 Tex.App. – San Antonio 2000, writ denied). The court may deny recovery of the independent executor's fees out of the estate even if not removed, where the court found the independent executor did not defend the removal action in good faith. *Kanz v. Hood,* 17 S.W.3d 311 (Tex.App. – Waco 2000, writ denied). A party seeking removal of an independent executor may recover reasonable attorney's fees and expenses out of the estate. TEX. PROB. CODE §149C(d). The estate can be liable for attorneys' fees to both sides in a action to remove an executor that is brought in good faith. *Garcia v. Garcia*, 878 S.W.2d 678 (Tex.App.–Corpus Christi 1994, no writ).

2. Bond

If a beneficiary has reason to believe that an independent executor is "mismanaging the property or has betrayed or is about to betray his trust, or has in some other way become disqualified," the beneficiary may petition the court to require a bond for the independent executor, even though the will provides for the independent executor to serve without bond. TEX. PROB. CODE § 149.

The bonding procedure is a cost effective and practical method which the Legislature provides to guard against the misbehavior and waste of independent executors. *Corpus Christi Bank and Trust v. Alice National Bank*, 444 S.W.2d 632 (Tex. 1969). If a bond is ordered, the powers of the executor are suspended, and the executor may not pay out any money of the estate or do any other official act except to preserve property of the estate until the bond has been given and approved. TEX. PROB. CODE § 207. If an executor cannot make the bond, the executor will be removed.

3. TRO/Temporary Injunction

A temporary restraining order (TRO) and temporary injunction are also available to a beneficiary of an estate. *See Farr v. Hall*, 553 S.W.2d 666, 672 (Tex.Civ.App.–Amarillo 1977, writ ref'd n.r.e.); *Bellinger v. Bellinger*, 694 S.W.2d 72, 75-76 (Tex.App.–Corpus Christi 1985, no writ). In *Farr,* the beneficiary obtained an injunction to stop executor's proposed stock redemption in violation of Section 352 of the Probate Code. The court of appeals affirmed the injunction and held that when there is clear statutory prohibition to the transaction, there is no necessity to show the absence of an adequate remedy at law. *Farr*, 553 S.W.2d at 672. *See also Kappus v. Kappus,* 284 S.W.3d 831 (Tex. 2009). The party objecting to the

independent executor's sale of property and seeking removal of the executor, obtained an injunction to prevent the sale from closing.

Seeking a temporary restraining order and temporary injunction also presents an excellent opportunity to obtain expedited and supervised discovery at the hearing on the temporary injunction that must take place within 14 days. TEX. R. CIV. P. 680. An injunction also may be the only way to protect the beneficiary and the estate assets from further damage in the event the executor will not be able to adequately respond in damages.

The procedural requirements for a temporary restraining order and temporary injunction are provided in Texas Rules of Civil Procedure 680-693. The trial court has broad discretion in determining whether to grant or deny a temporary injunction. *Transport Company of Texas v. Robertson Transports,* 261 S.W.2d 549 (1953). At the temporary injunction hearing, the only issue before the trial court is whether the applicant is entitled to preservation of the status quo of the subject matter of the suit pending trial on the merits. *Davis v. Huey,* 571 S.W.2d 859 (Tex. 1978). An order granting a temporary injunction will not be reversed on appeal absent a clear abuse of discretion. *State v. Southwestern Bell Telephone Co.,* 526 S.W.2d 526 (Tex. 1975).

The applicant must establish that there is no adequate remedy at law and that irreparable injury will result if the relief is not granted. *See Alwar Had v. America's Favorite Chicken Co.*, 921 S.W.2d 728, 730 (Tex.App.–Corpus Christi 1996, writ dism'd w.o.j.); *Ballenger v. Ballenger*, 694 S.W.2d 72, 76 (Tex.App.–Corpus Christi 1985, no writ). The test for determining adequacy of an existing remedy is whether the remedy is as complete, practical, and efficient to the ends of justice and its prompt administration, as is equitable relief. No adequate remedy at law will exist if damages are incapable of calculation, or if the defendant is incapable of responding in damages.

4. Receiver

The Texas Civil Practice and Remedies Code provides that a receivership may be created in any case in which "a receiver may be appointed under the rules of equity." TEX. CIV. PRAC. & REM CODE § 64.001(a)(6). Texas courts have allowed a receivership over a decedent's estate when there is an existing independent administration over the estate. *Griggs v. Brewster*, 62 S.W.2d 980, 986 (Tex. 1933). The rules of equity allow a receivership only when it is shown to be reasonably necessary for preservation of property involved in litigation, and for the protection of rights of persons having claims against it. The party seeking a receivership must have an interest, or a probable interest, in the property in question. It must also be shown that the property or fund is in danger of being lost, removed, or materially injured if left in the hands of the person in possession of the property. Finally, there must be no other remedy available to the petitioner that is adequate and complete.

A receiver has been appointed in an estate is the following cases:

O'Connor v. O'Connor, 320 S.W.2d 384, 389 (Tex.Civ.App.–Dallas 1959, writ dism'd) (receiver appointed when independent executor refused to account to the beneficiary).

Hake v. Dillworth, 96 S.W.2d 121, 122 (Tex.Civ.App.–Waco 1936, writ dism'd) (receiver appointed to sell remaining estate assets and distribute the proceeds due to a dispute over whether the estate was ready for distribution, executor's commission, and whether the executor mismanaged the estate).

*Freeman v. Bank*s, 91 S.W.2d 1077, 1080 (Tex.Civ.App.–Fort Worth, 1936 writ ref'd) (receiver appointed upon removal of an independent executor).

Blalack v. Blalack, 424 S.W.2d 646, 650 (Tex.Civ.App. – Texarkana 1968, no writ)(receiver

appointed due to impasse between independent co-executors).

Metting v. Metting, 431 S.W.2d 906, 907 (Tex.Civ.App. – San Antonio 1968, no writ)(receiver appointed in will construction suit where executor was a beneficiary and there was a dispute about the order of abatement of the estate).

Roy v. Roy, 234 S.W.2d 933, 935 (Tex.Civ.App. – Eastland 1950, no writ)(in suit to partition community property brought by the surviving spouse against the deceased spouse's independent executor, receiver could be appointed to sell the land and partition the proceeds);

Horn v. Sankary, 161 S.W.2d 156, 158 (Tex.Civ.App. – Fort Worth 1942, no writ)(receiver appointed in suit by tenants in common with estate property).

Griggs v. Brewster, 62 S.W.2d 980, 985 (Tex. 1933)(receiver appointed in will construction suit including allegations of conversion by executor).

Freeman v. Banks, 91 S.W.2d 1078, 1080 (Tex.Civ.App. – Fort Worth 1936, writ ref'd)(receiver appointed upon removal of an independent executor).

In *Gonzales v. Gonzales, Metting v. Metting,* and *Blalack v. Blalack,* the courts held that the Section 149 bond procedure was not adequate or complete and thus was not a sufficient alternative to a receivership.

5. Criminal Sanctions

If the executor wastes all of the estate and is not financially responsible to make any reimbursement to the estate, the only remedy left for the beneficiary is to seek criminal sanctions. Section 32.45 of the Texas Penal Code is a very broad criminal remedy. It covers trustees, guardians, administrators, executors, conservators, and receivers. It also covers any officer, manager, employee, or agent of a executor. A criminal offense occurs under this Section as follows:

> A person commits an offense if he intentionally, knowingly, or recklessly misapplies property he holds as a fiduciary or property of a financial institution in a manner that involves substantial risk of loss to the owner of the property or to a person for whose benefit the property is held.

TEX. PEN. CODE ANN. § 32.45 (West 2005). The offense is a first degree felony if the value of the property in question is $200,000 or more, a second degree felony if the value of the property in question is $100,000 or more but less than $200,000, a third degree felony if the value of the property in question is $20,000 or more but less than $100,000, and a state jail felony if the value of the property in question is $1,500 or more but less than $20,000, and a misdemeanor if less.

6. Deceptive Trade Practices Act

The Deceptive Trade Practices-Consumer Protection Act ("DTPA") was enacted by the Texas legislature in 1973 "to protect consumers against false, misleading and deceptive business practices, unconscionable actions, and breaches of warranty and to provide efficient and economical procedures to secure such protection." TEX. BUS. & COM. CODE ANN. § 17.44(a) (West 2005). To recover under the DTPA, a plaintiff must establish that he or she is a "consumer" as defined in the statute. In 1995, the DTPA was amended to provide exemptions for the rendering of professional services, the essence of which is to provide advice, judgment, opinion or similar professional skill. *See* TEX. BUS. & COM. CODE ANN. §17.49(c) (West 2005). *See Underkofler v. Vanasek*, 53 S.W.3d 343 (Tex. 2001) (discussing applicable statute of limitations for DTPA claims, as well as exceptions).

Due to the exemption provided in Section 17.49(c), it is clear that a client of an attorney is not a consumer for the purposes of the DTPA. *See*

Latham v. Castillo, 972 S.W.2d 66, 68 (Tex. 1998). Section 17.49(c) provides that an exemption for claims for damages based on the rendering of a professional service, "the essence of which is the providing of advice, judgment, opinion, or similar professional skill," with the exception of:

> a. an express misrepresentation of a material fact that cannot be characterized as advice, judgment or opinion;
>
> b. a failure to disclose known information about goods or services with intent, thereby, to induce the consumer to enter into the transaction;
>
> c. an unconscionable action or course of action that cannot be characterized as advice, judgment or opinion; or
>
> d. breach of an expressed warranty that cannot be characterized as advice, judgment, or opinion.

In *Latham v. Castillo*, 972 S.W.2d 66, 68 (Tex. 1998), the Texas Supreme Court, stated, in dicta, that the 1995 amendments to the DTPA ensure that lawyers may not be sued under the DTPA unless they engage in one of the acts listed in Section 17.49(c)(1)-(4) (see above). Similarly, in *Murphy v. Campbell*, 964 S.W.2d 265, 269 (Tex. 1997), the Texas Supreme Court held that Section 17.49 prevented a DTPA claim against accountants on the grounds of faulty tax advice. Specifically, the court held "there is no cause of action for breach of implied warranty of accounting services." *Id*.

Based on *Latham* and *Murphy*, it is clear that an attorney or an accountant is ordinarily exempt from a DTPA claim for rendering of advice, judgment, opinion or similar professional skill. However, no Texas case has answered whether an individual or corporate fiduciary is exempt from the DTPA pursuant to Section 17.49(c). Arguably, some if not all of the services provided by a professional fiduciary are professional services, the essence of which is providing advice or similar professional skill. To say the least, it can be expected that corporate fiduciaries will assert the Section 17.49(c) exemption as DTPA defense.

D. Consider No Contest Clause

A beneficiary must always be concerned about whether a suit or other action will violate a no contest or forfeiture clause. When the governing document contains a no contest clause, the executor invariably will be tempted to hide behind it when the beneficiary questions the quality of the executor's performance. Although the executor's threats to invoke the no contest clause rarely are effective when the beneficiary's claims have merit, there is always concern when such a clause is present.

The Probate Code now contains a good faith and probable cause exemption from a forfeiture clause. Under Section 64 (effective 9/1/09), a forfeiture provision in a will is not enforceable against a person for bringing any court action if:

> (1) probable cause exists for bringing the action; and
>
> (2) the action is maintained in good faith.

TEX. PROB. CODE § 64. Enactment of this Section 64 in 2009 was meant to clarify existing law in Texas.

The general rule is that a contest is any legal proceeding that is designed to thwart the intentions of the testator. *See Hodge v. Ellis*, 268 S.W.2d 275, 287 (Tex.Civ.App.–Fort Worth 1954), aff'd in part, ref'd in part, 277 S.W.2d 900 (Tex. 1955). Texas courts strictly construe no contest clauses. *See Badouh v. Hale*, 22 S.W.3d 392 (Tex. 2000). The no contest clause must spell out in clear and specific language the action which would trigger forfeiture.

The challenge of an individual's suitability to be appointed executor has been held not to fall

within the no contest clause. *In Re: Estate of Newbill*, 781 S.W.2d 727, 729 (Tex.Civ.App.–Amarillo 1989, no writ). An action to construe a will or parts of the will is not a contest or does not invoke the no contest clause of the will. *In Re: Estate of Hodges*, 725 S.W.2d 265, 268 (Tex.App.–Amarillo 1986, writ ref'd n.r.e.); *Roberts v. Caesium*, 238 S.W.2d 822, 825 (Tex.Civ.App.–Eastman 1951, no writ). The demand for an accounting partition and distribution has not been held to invoke a no contest clause. *In Re: Estate of Minnick*, 653 S.W.2d 503, 507-508 (Tex.App.–Amarillo 1983, no writ; *Bethurum v. Browder*, 216 S.W.2d 992, 995 (Tex.Civ.App.–El Paso 1948, writ ref'd n.r.e.).

III. TRUSTS

A. Information Rights

1. Trustee's Common Law Duty to Disclose

A fiduciary has an affirmative duty to make a full and accurate disclosure of all material facts that might affect the beneficiary's rights. *Huie v. DeShazo, 922 S.W.2d 920 (Tex. 1996); Montgomery v. Kennedy, 669 S.W. 2d 309 (Tex. 1984)*; *Kinszbach Tool Co. Inc. v. Corbett-Wallace Corp., 160 S.W.2d 509 (Tex. 1942); Texas Bank & Trust Co. v. Moore, 595 S.W.2d 502, 508-09 (Tex.1980); Baird v. Mills, 119 S.W.2d 889, 892 (Tex.Civ.App.-Austin 1938, writ ref'd); InterFirst Bank Dallas, N.A. v. Risser, 739 S.W.2d 882 (Tex.App.-Texarkana 1987, no writ); Bogert, The Law of Trusts and Trustees (6th ed. 2006) §§ 961-974 ("Bogert"); Restatement (2d) of Trusts §§ 172-173 ("Restatement").* The rationale for this rule is described by William E. Fratcher, *Scott On Trusts (4th ed. 1988) §173 ("Scott")*:

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

A trustee has a fiduciary duty, upon demand by the beneficiary, to furnish the beneficiary with a formal trust accounting; to inform a beneficiary of the nature and amount of the trust property, the trustee's management actions, and the intent of the trustee regarding the future administration of the trust estate; and to allow the beneficiary to inspect the books and records of the trust. *Shannon v. First National Bank, 533 S.W.2d 389 (Tex.Civ.App.1976, writ ref'd n.r.e.)*; *Restatement §173. See also* the legislative history accompanying the 2007 repeal of Trust Code § 113.060, which was enacted in 2005 to impose on trustees a statutory duty to keep beneficiaries reasonably informed concerning the trust's administration and "the material facts necessary for the beneficiaries to protect [their] interests." The legislative history states: "The enactment of Section 113.060 was not intended to repeal any common-law duty to keep a beneficiary reasonably informed, and the repeal by this Act of Section 113.060 does not repeal any common-law duty to keep a beneficiary informed. The common-law duty to keep a beneficiary informed that existed immediately before January 1, 2006, is continued in effect." Section 22 of Acts 2007, 80th Leg., ch. 451.

2. Trust Instrument

A trust instrument may limit, but not entirely defeat, the trustee's common law duty of

disclosure. The terms of a trust prevail except as the Texas Trust Code specifically provides otherwise. TEX. TRUST CODE §§111.0035(b), 113.001. The terms of a trust may not limit the following duties regarding disclosure:

a. The duty of a trustee of an irrevocable trust to respond to a demand for an accounting by a beneficiary who is either currently permitted to receive distributions from the trust (a "current beneficiary") or would be if the trust terminated at that time (a "first-tier remainder beneficiary"). TEX. TRUST CODE §111.0035(b)(4).

b. Any common law duty to inform a current or first-tier remainder beneficiary of an irrevocable trust who is age 25 or older. TEX. TRUST CODE §111.0035(c). (A settlor can restrict or even eliminate the right of other beneficiaries to demand an accounting, including contingent remainder beneficiaries.)

3. Texas Trust Code Accounting

Unless required by the trust instrument, a trustee has no duty to make periodic accountings to the beneficiaries under Texas law. However, the Texas Trust Code gives a beneficiary the right to demand a written accounting of all of the trust transactions from inception or since the last accounting. TEX. TRUST CODE § 113.151. Except in unusual circumstances, a trustee is not required to provide an accounting more frequently than once every 12 months. If the trustee fails or refuses to provide an accounting within 90 days, the beneficiary may file suit to compel the trustee to provide the accounting. If the beneficiary is successful, the court may order the trustee in his individual capacity to pay all of the beneficiary's attorney's fees. *Id.*

An "interested person" also may file suit to compel the trustee to provide an accounting. The court will order the trustee to account if it finds that "the nature of the interest in the trust of, the claim against the trust by, or the effect of the administration of the trust on the interested person is sufficient to require an accounting by the trustee." Tex. Trust Code §113.151(b). An "interested person" includes a trustee, beneficiary, or any other person having an interest in or claim against the trust or any person who is affected by the administration of the trust. "Whether a person, excluding a trustee or named beneficiary, is an interested person may vary from time to time and must be determined according to the particular purposes of and matter involved in any proceeding." Tex. Trust Code §111.004(7).

A Trust Code accounting is an allocation of cash received and cash disbursed between principal and income and a description of all financial transactions affecting the trust. The contents of an accounting are prescribed by Trust Code Section 113.152:

1. The trust property that has been received and was not previously listed in a prior accounting.

2. A list of receipts and disbursements, allocated between income and principal.

3. A list and description of all property being administered (with descriptions).

4. Cash accounts, their balance, and where they are deposited.

5. A list of all trust liabilities.

A trust accounting is the primary vehicle through which a beneficiary obtains the information necessary to understand and protect his interests and enforce his rights. The accounting should be in understandable form and include all information necessary for the beneficiary to get a complete picture of the trust administration during the time period covered. The detail required in an accounting and the amount of time required to prepare the accounting will depend on the nature of

the trust assets and the activity (receipts of income, sales of assets, investments, payment of expenses and distributions to beneficiaries) of the trust.

An accounting also may put the beneficiary on notice of the trustee's acts for purposes of the statute of limitations on claims against the trustee. The statute of limitations for breach of fiduciary duty claims and most other trust-related actions is four years. TEX. CIV. PRAC. & REM. CODE ANN. §§ 16.004, 16.051. The discovery rule applies, so the statute does not begin running until the facts constituting a cause of action are discovered. *Seay v. Burnett Trust,* 187 S.W.2d 377 (Tex. 1945). The statute may be tolled during a beneficiary's minority or disability. If a transaction has been fully disclosed in an accounting, the accounting may be used to bar claims relating to such disclosed transactions more than four years later. However, an accounting does not settle a trustee's tort liability. *Texas State Bank v. Amaro*, 87 S.W.3d 538 (Tex. 2002). Approval of the trustee's investment philosophy and adjudication of the trustee's potential tort liability to the beneficiary was not proper in connection with the approval of an accounting, as these matters were not components of an accounting. *Id.*

A trustee may use the cost of a trust code accounting as a threat to discourage the beneficiary from pursuing that remedy. Based on the trustee's duty to maintain proper books and records, however, the trustee's records should permit the preparation of a trust accounting at a reasonable cost and in a reasonable period of time. If the trustee has not maintained his records in this manner, then he may have committed a breach of the duty to maintain proper books and records. Any portion of the cost of preparation of the accounting that is attributable to the trustee's inadequate records arguably should be borne by the trustee individually. The trustee also should take make reasonable efforts to procure a trust accounting at a reasonable cost.

4. Trust Code Accounting Alternatives

A formal Trust Code accounting may be expensive and the reasonable and necessary cost generally is a proper trust expense. A trustee may attempt to provide some type of substitute to a formal accounting. The beneficiary is not obligated to accept anything less than a full and complete accounting meeting all of the requirements of the Trust Code. However, to avoid the expense of a formal accounting, there may be circumstances in which a beneficiary may want to consider an alternative, less costly method of obtaining the desired information, at least as a preliminary step. This approach may be particularly useful for a trust that has been in existence for many years and for which no accounting has ever been provided.

Consideration of an alternative method of obtaining trust information should be made through a written request to the trustee that makes clear that the beneficiary is not waiving his right to a statutory accounting and may ultimately decide to request a formal trust accounting after reviewing the requested information. Since this request is being made in an effort to spare the trust the substantial cost of preparing a formal accounting, it is reasonable for the trust to bear the costs of providing the requested records. If the records are voluminous, it may be preferable for the beneficiary (or his representative) to initially inspect the records at the trust office and then obtain copies of only documents regarding specific areas of concern. If the beneficiary will need professional assistance in making this initial review and expects the trust to pay those fees, this should be approved in advance by the trustee.

a. Inspect the Trust's Books and Records

A trustee has a duty to keep accurate, complete and orderly books and records for the trust. In addition to financial records, a trustee has the 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.); *Bogert* § 962. There is no statute specifically requiring a trustee to

keep accurate books and records, but proper books and records are essential for the trustee to properly administer a trust, including compliance with the trustee's duty to provide proper disclosure, prepare a statutory accounting, determine trust income for distributions, and prepare trust tax returns. *Corpus Christi Bank & Trust v. Roberts,* 587 S.W.2d 173 (Tex.Civ.App. – Corpus Christi 1979), reformed in part on other grounds and aff'd in part, 597 S.W.2d 752 (Tex. 1980). A trustee has a fiduciary duty, upon demand, to allow a beneficiary on a reasonable basis to inspect the non-privileged books and records of the trust. *Restatement* §82; *Scott* §173; and *Bogert* §961. *See also Shannon v. Frost National Bank, supra.*

The primary source documents would include all trust bank statements and brokerage statements. Most corporate trustees generate periodic statements that reflect the financial transactions on a trust accounting basis. In most instances, these statements should be sufficient to answer questions or concerns of a beneficiary, particularly where the trustee is responsive to requests for supplemental information on specific items and/or willing to meet to discuss questions or concerns. An individual trustee, however, may not maintain or be able to provide similar statements. Depending on the level of activity of the trust and the time period under question, the process of reviewing the primary source documents and compiling the information into a useful format could be cost prohibitive for the beneficiary.

b. Financial Accounting Records

Financial statements, whether or not maintained in accordance with generally accepted accounting principles, do not meet the requirements of a Trust Code accounting. Even most individual trustees (though not all) maintain some type of trust books and records on computer software, such as Quicken. These programs do not produce Trust Code accountings because they are not usually set up to make principal and income allocations (although this can be done in Quicken and there are specific trust accounting programs). This concept of allocation is foreign to financial accounting principles.

Nevertheless, the underlying financial data input into these programs should include all of the trust's cash receipts and cash disbursements, from which a "cash receipts and disbursements journal" or "general ledger" can be generated listing receipts and disbursements in categories that may facilitate an affordable, comprehensive review of pertinent transactions. These programs also typically produce financial statements, including an income statement and balance sheet. Although an income statement does not reflect trust accounting income, with some adjustments, trust accounting income may be computable or at least closely approximated. The balance sheet shows only a "snapshot" of the trust's assets and liabilities on a specific date, but a comparison of several years will show significant changes in assets and liabilities.

c. Income Tax Returns

A trust's federal income tax return (Form 1041) does not contain all of the information required for a Trust Code accounting. In most cases, the taxable income of a trust will differ from its trust accounting income. A common example reflecting the difference arises with the sale of a trust asset. All of the cash received from the sale sales proceeds typically will be treated as trust principal for trust accounting purposes, but for income tax purposes, only the gain will be reported. Also, the computation of taxable income does not incorporate the concept of allocating receipts and disbursements between principal and income, includes a deduction for distributions to beneficiaries, and is subject to a myriad of special tax rules. However, again with adjustments and some supplemental information, it may be possible to "back into" a least a close approximation of trust accounting income from the trust's income tax return.

In fact, the trust's "accounting income" is required to be reported on Schedule B, line 8, of

Form 1041 for a complex trust "for the tax year as determined under the governing instrument and applicable local law." Obtaining the work papers and underlying support documents used to compute such "accounting income" could provide a wealth of information. A word of caution, however, in relying on trust income tax returns for trust accounting information. The author has seen many trust income tax returns that are not properly prepared, apparently due to a lack of experience with, or understanding of, trust income taxation rules and the distinction between trust taxable income and trust accounting income. This observation is not a criticism of accountants or tax preparers but is a reflection of the complexity of the trust taxation rules, the infrequent opportunities for most accountants to prepare trust tax returns, the scarcity of applicable law in the area, and (thankfully) the infrequency of IRS audits of trust income tax returns. The income taxation of trusts and estates is extremely complex and is far beyond the scope of this paper.

B. Distribution Rights

1. Trustee's Duty to Make Distributions

The most important right to a trust beneficiary is obviously the right to receive financial benefits from the trust. The trustee has a duty to make distributions in accordance with the trust instrument. TEX. TRUST CODE §113.051. Distributions may be mandatory or within the trustee's discretion.

a. Mandatory Distributions

A mandatory distribution requires the distribution of income and/or principal, or both, in a manner that does not require the exercise of a trustee's discretion. The most common mandatory distributions involve the distribution of all the trust's income. For example, for a trust to qualify for the estate tax marital deduction, the trustee must be required to distribute all income to the surviving spouse. I.R.C. §2056(b)(7). Although a trustee does not have discretion whether to distribute income when the trust contains a mandatory income distribution requirement, there still may be discretionary actions involved in determining the amount of such income. *See* III.B.2. *infra.*

b. Discretionary Distributions Subject to an Ascertainable Standard

Discretionary distributions may be subject to an ascertainable standard or may be purely discretionary. The most commonly used ascertainable standard for making trust distributions is "health, education, maintenance and support." With this type of standard, the trustee must exercise his discretion to determine the appropriate distributions to meet the health, education, support and maintenance needs of the beneficiary. The trustee also must protect the interests of the remainder beneficiaries.

c. Pure Discretionary Trusts

A trust is not required to contain an ascertainable distribution standard. A settlor may provide that distributions can be made in the trustee's sole discretion or may use a vague term for which there is no objective manner to determine whether a distribution conforms to the standard. Terms that may provide unascertainable standards include: comfort, happiness, benefit, and welfare. See Treas. Reg. §20.2041-1(c)(2) ("a power to use property for the comfort, welfare, or happiness of the holder of the power is not limited by the requisite standard."); and Treas. Reg. §1.674(b)-1(b)(5)(I) (a power to distribute corpus for pleasure, desire, or happiness of a beneficiary is not limited by a reasonably definite standard).

The beneficiary of a purely discretionary trust may not compel the trustee to make trust distributions. *See Burns v. Miller, Hiersche, martens & Hayward, P.C., 948 S.W.2d 317 (Tex.App.–Dallas, 1997, writ denied); Restatement (2d) §155, comments note e; and Bogert §228. See also Ridgell v. Ridgell, 960 S.W.2d 144 (Tex.App.-Corpus Christi 1997, writ denied)..* In extreme circumstances, a beneficiary may be able to convince a court that a trustee's refusal to exercise his discretion is so unreasonable as to constitute a

breach of trust or to justify removal.

d. No Absolute Discretion

Despite language in the trust instrument that the trustee has "sole and absolute discretion" to determine distributions in accordance with a specified standard, there is no such thing as absolute discretion. This well-settled principle has now been codified in the Texas Trust Code. New Trust Code Section 113.029(a) (effective 9/1/09), states:

> Notwithstanding the breadth of discretion granted to a trustee in the terms of the trust, including the use of terms such as "absolute," "sole," or "uncontrolled," the trustee shall exercise a discretionary power in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries.

A court generally will not substitute its own discretion for that of a trustee. However, the court will not permit a trustee to abuse his discretion. *See Coffee v. William Marsh Rice University,* 408 S.W.2d 269 (Tex.Civ.App. – Houston 1966); *Brown v. Sherck,* 393 S.W.2d 172 (Tex.Civ.App. – Corpus Christi, 1965, no writ); and *Nations v. Ulmer,* 122 S.W.2d 700 (Tex.Civ.App. – El Paso, 1938). A trustee's discretion is not unbridled discretion. *State v. Rubion,* 308 S.W.2d 4 (Tex. 1957); *First National Bank of Beaumont v. Howard,* 229 S.W.2d 781, 785 (Tex. 1950); *Anderson v. Menefee,* 174 S.W. 904 (Tex.Civ.App. – Ft. Worth 1915, writ ref'd); *Scott,* §187 p. 986.

A trustee may abuse his discretion if the trustee acts outside the bounds of "reasonably judgment." Scott §187. Use of the terms "absolute," "uncontrolled," "sole" and "exclusive" in granting discretion to a trustee does not completely absolve the fiduciary from acting reasonable. *First National Bank v. Howard; Thorman v. Carr,* 412 S.W.2d 45 (Tex. 1967).

It is an abuse of discretion for a trustee to fail to exercise judgment at all, no matter how broad the standard. Scott §187.3. The trustee's discretion must be "reasonably exercised to accomplish the purposes of the trust according to the settlor's intention and his exercise thereof is subject to judicial review and control." *Scott,* §§187, 187.1, 187.2, and 187.3; *Kelly v. Womack,* 268 S.W.2d 903, 907 (Tex. 1954); *Powell v. Parks,* 86 S.W.2d 725 (Tex. 1935); *Davis v. Davis,* 44 S.W.2d 447 (Tex.Civ.App. – Texarkana 1931, no writ).

2. <u>Distributions From Income</u>

a. Definition of Trust Income

If a beneficiary is entitled to distributions of or solely from income, the income of the trust that is available for distribution during the requisite period must be determined. This computation is necessary whether or not a trust accounting has been demanded. "Trust income" is a unique creature of trust law. It is defined in Section 116.002(4) of the Trust Code as "money or property that a fiduciary receives as current return from a principal asset." Trust income differs from financial accounting income and taxable income. Unlike financial income and taxable income, which may be based on accrual principles, trust income is computed on a cash basis. Trust income is not the excess of cash receipts over cash disbursements. Trust income is:

> (1) the excess of cash receipts that are properly characterized under the trust law and/or trust instrument as trust income (rather than trust principal),
>
> (2) less cash disbursements properly charged against such income,
>
> (3) reduced by distributions from income,
>
> (4) adjusted for any proper transfers to or from principal.

Any remaining cash (or property) will constitute trust principal. Thus, cash held by a trust usually will be divisible between the "income cash" and the

"principal cash." These combined amounts must reconcile with cash balances reflected in bank and financial account records.

b. Allocations of Principal and Income

To determine trust accounting income, cash receipts and disbursements must be allocated between principal and income. These allocations are mandated by the trust or trust law, and failure to make them will likely result in improper distributions. The terms of the trust, and to the extent not addressed, Chapter 116 of the Texas Trust Code (the "Uniform Principal and Income Act"), as well as common law principles, govern allocations of receipts and disbursements between income and principal. Even if the trust instrument grants the trustee discretion in allocating receipts and disbursements, a trustee cannot exercise that discretion arbitrarily. Whether granted by the terms of the trust, a will or the Trust Code, a fiduciary must act impartially, and based on what is fair and reasonable to all of the beneficiaries. TEX. TRUST CODE §116.004(b). *Thorman v. Carr, 408 S.W.2d 259 (Tex.Civ.App. – San Antonio 1966), aft'd per curiam, 412 S.W.2d 45 (1967).* An allocation made in accordance with the provision of the Texas Trust Code will be presumed to be fair and reasonable to all beneficiaries. If neither the terms of the trust nor the Trust Code provide a rule for allocating between principal and income, the item should be allocated to principal. TEX. TRUST CODE §116.004(a)(4).

The Uniform Principal and Income Act ("UP&IA") (effective 1/1/04) provides a comprehensive new treatment of the subject of allocating receipts and disbursements between principal and income. The Texas UP&IA is a default statute – the trust controls, but if it instrument is silent, the UP&IA rules apply, but if the trust instrument specifies other rules apply. The chart attached as Appendix "A" describes some of the default allocation rules provided by the UP&IA:

The information to analyze these issues should be contained in the accounting or accounting records that have been provided. If not, specific documents relating to these items should be requested. The beneficiary may request an explanation from the trustee of all factors considered in determining the income available for distribution and how the amount of the distribution was determined.

c. Object to Amount of Expenses

Another area of scrutiny relating to the amount of trust income available for distribution is the reasonableness and necessity for any expenses paid out of trust income.

3. Distributions From Income or Principal

If a beneficiary is entitled to distributions from income and/or principal, concerns generally will relate to the amount of the distribution (i.e., it is not enough), rather than on principal and income allocations. The amount of expenses, however, may also be an issue. If the distribution is subject to an ascertainable standard, the trustee must exercise his discretion to determine the amount appropriate under that standard. The trustee has a duty to reasonably exercise his discretion. This includes making an informed decision based on the trust terms and in order to carry out the settlor's intent as expressed in the trust. I the trustee fails to do so, he will have breached his fiduciary duty. However, rather than seek court intervention as a first resort, a proactive beneficiary should voluntarily supply the trustee with information to support the desired distribution amount. In *Rubio*, 308 S.W. at 10, the court described the following factors that should be considered by the trustee in exercising its discretion in a support or maintenance trust, including:

* the size of the trust estate;
* the beneficiary's age, life expectancy, and condition in life;
* the beneficiary's present and future needs;
* the other resources available to the beneficiary's individual wealth; and

* the beneficiary's present and future health, both mental and physical.

Id. at 10-11. *See also In re Gruber's Will,* 122 N.Y.S.2d 654, 657 (N.Y. Sur. 1953)(age and condition of beneficiary, amount of trust fund, and other factors); *Hanford v. Clancy,* 183 A. 271, 272 (N.H. 1936)(size of fund, present situation of beneficiary, present and future needs, other resources, and future emergencies); *Falsey's Estate, Sur.,* 56 N.Y.S.2d 556, 563 (N.Y. Sur. 1945)(age of beneficiary, physical and mental health of beneficiary, size of trust compared to beneficiary's life expectancy).

Support and maintenance are generally considered synonymous terms. Support means more than the bare necessities of life. *Hartford-Connecticut Trust Co. v. Eaton,* 36 F.2d 710(2d) (Cir. 1929). It generally includes ordinary living expenses. Restatement (3d) of Trusts §50 cmt d (2003).

The size of the trust and the needs of the current versus future beneficiaries also must be considered. These considerations require a constant balancing of all relevant factors. The appropriate standard for support may change over time depending on changes in the beneficiary's standard of living, the trust's productivity, or lack thereof. (When the trust is potentially insufficient to provide for both the needs of the current beneficiary and the future beneficiaries, the trustee is faced with a difficult decision.) It is important for the proactive beneficiary seeking additional distributions to be able to make a plausible argument to the trustee that either the assets are sufficient for both or that the needs of the current beneficiary take precedence.

The beneficiary should provide to the trustee documentation of his income and cash flow, income, assets and debts, tax returns, insurance information, employment information, and a budget reflecting his expenses and needs. The budget should include ordinary expenses as well as extraordinary expenses such as customary vacations and entertainment, and luxury items. Also, the beneficiary should provide a history of assistance previously supplied by the settlor and information to establish his standard of living. The beneficiary also should take steps to verify that the trust assets are sufficient to provide distributions at the requested level throughout the life of the trust for all beneficiaries. Emphasis should be made to any language in the trust that indicates preference should be given to the beneficiary..

A beneficiary also may seek information from the trustee in order to support a distribution request or to justify the trustee's distribution decisions. The Restatement (3d) provides that among a trustee's fiduciary duties is the (I) general duty to act, reasonably informed, with impartiality among the various beneficiaries and interests. (Section 79) and (ii) duty to provide the beneficiaries with information concerning the trust and its administration (Section 82). The Restatement concludes "this combination of duties entitles the beneficiaries (and also the court) not only to accounting information but also to relevant, general information concerning the bases upon which the trustee's discretionary judgments have been or will be made. *See Restatement (3d)* §50 cmt g (general observations on relevant factors in the interpretation of discretionary powers). If the beneficiary and the trustee cannot reach an agreement regarding distributions, the beneficiary should request information from the trustee to justify his decision. This request should include a request for a written explanation of the basis for the trustees decision, identification of all information considered, copies of documents considered, and other steps involved in the investigation conducted by the trustee in making the decision. If the trustee is a corporate trustee, the trust officer's file, trust committee records relating to the trust and the trustee's procedural manual regarding distributions should be requested.

C. Rights Concerning Investments

1. Uniform Prudent Investor Act

The Uniform Prudent Investor Act ("UPIA") (effective 1/1/04) is contained in Chapter 117 of the Texas Trust Code. Section 117.003(a) of the Texas Trust Code provides that a trustee owes a duty to the beneficiaries of the trust to comply with the "prudent investor rule," set forth in the statute. However, the prudent investor rule is a default rule and may be expanded, restricted, eliminated or otherwise altered by the provisions of a trust. A trustee is not liable to a beneficiary if the trustee acted in reasonable reliance on the provisions of a trust. TEX. TRUST CODE §§117.003(b).

a. Standard of Care

Under the prudent investor rule, a trustee must 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. TEX. TRUST CODE §117.004(a). 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. TEX. TRUST CODE §117.004(b). In making investment and management decisions, the trustee is required to consider the following:

(1) General economic conditions;

(2) The possible effect of inflation or deflation;

(3) The expected tax consequences of investment decisions or strategy;

(4) The role that each investment plays within the overall trust portfolio;

(5) The expected total return from income and the appreciation of capital;

(6) Other resources of the beneficiary;

(7) Needs for liquidity, income and preservation or appreciation of capital; and

(8) An asset's special relationship or special value, if any, to the trust or a beneficiary.

TEX. TRUST CODE §117.004(c). A trustee may invest in any kind of property or type of investment consistent with the standard of the UPIA. TEX. TRUST CODE §117.004(e). A trustee who has special skills or expertise has a duty to use those special skills or expertise. TEX. TRUST CODE §117.004(c).

b. Diversification

Section 117.005 of the Texas Trust Code mandates that a trustee diversify the investments. No guidance is provided regarding what is proper diversification. If the trustee "reasonably determines that, because of special circumstances, the purpose of the trust are better served without diversifying," then the trustee is not required to diversify. The Comments suggest some possible special circumstances could include tax considerations, ownership of a family business, and securities law issues.

c. Duties at Inception of Trusteeship

Section 117.006 requires a trustee "within a reasonable time after accepting a trusteeship or receiving trust assets," to "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 [the UPIA]."

Former Section 113.003, which allowed a trustee to retain property constituting initial trust corpus without regard to diversification, has been repealed.

d. Duty of Loyalty

Section 117.007 of the Texas Trust Code provides that a "trustee shall invest and manage the

trust assets solely in the interest of the beneficiaries."

e. Duty of Impartiality

"If a trust has two or more beneficiaries, the trustee shall act impartially in investing and managing the trust assets, taking into account any differing interests of the beneficiaries." TEX. TRUST CODE §117.008.

f. Delegation of Investment and Management Functions

Under prior law, a trustee was permitted to delegate investment and management functions, but the trustee remained primarily responsible for the activities of the trust. Section §117.011 now permits the trustee to avoid liability for the actions of the trustee's agent if such duties are properly delegated.

(1) Duties When Delegating

"A trustee may delegate investment and management functions that a prudent trustee of comparable skills could properly delegate under the circumstances." TEX. TRUST CODE §117.011(a). The trustee must use "reasonable care, skill and caution in (1) selecting an agent; (2) establishing the scope and terms of the delegations, 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."

(2) Duty of Agent

An agent to the fiduciary assumes the statutory obligation to the trust to exercise reasonable care to comply with the terms of the delegation. TEX. TRUST CODE §117.011(b). Further, the agent submits to the jurisdiction of the courts of the State of Texas. TEX. TRUST CODE §117.011(d).

(3) Avoidance of Liability

A trustee who delegates investment and management functions in accordance with §117.011(a), is not liable for the decisions or actions of the agent, provided that:

(a) the agent is not an affiliate of the trustee, or

(b) the agent does not have a binding arbitration clause in its agreement and the generally applicable statute of limitations under Texas law for any action against the agent is not shortened. TEX. TRUST CODE §117.011(c).

g. Principles of Prudence

The Restatement (3d) specifies fundamental principles to prudent investing, including:

(1) Diversification. Trustees have a duty to diversify the investments of the trust estate.

(2) Risk/Return Analysis. Trustees "have a duty to analyze and make conscious decisions concerning the levels of risk appropriate to the purposes, distribution requirements, and other circumstances of the trust they administer."

(3) Cost Avoidance. Trustees have a "duty to avoid fees, transaction costs and other expenses that are not justified by needs and realistic objectives of the trust's investment program."

(4) Balancing. A Trustee has the duty (because of the duty of impartiality) to balance the elements of return between production of current income and protection of purchasing power.

(5) Delegation. A Trustee may have a

duty (as well as having the authority) to delegate some of his investment duties, as a prudent investor would.

There is an inherent conflict between the investment desires of the income or current beneficiaries versus the remainder beneficiaries. Income beneficiaries want investments that generate the maximum amount of income so as to increase the amount of their distributions. Remainder beneficiaries, on the other hand, want investments that will increase the corpus and want to minimize the amount distributed to income beneficiaries. The trustee has the duty to invest the assets in an impartial manner, considering the interests of both current and remainder beneficiaries. TEX. TRUST CODE §117.008.

The trustee should have an investment policy and should follow it in making investment decisions. The investment policy should include appropriate risk levels, allocation ratios for proper types of investments, and projected rates of return, based on the specific trust assets, trust terms, and needs of the beneficiaries. A current beneficiary who is unhappy with the trustee's investment portfolio may want to request information from the trustee, including:

(1) a written description of the trustee's investment policy;

(2) actual rate of return on the trust's investments, including income and growth, over a period of years;

(3) Comparison of rates of return to projected rate of return and appropriate benchmarks and an explanation regarding any significant disparity with the trust's rate of return;

(4) Portfolio allocation (% allocated to each class of assets, such as equities and fixed investments);

(5) Guidelines used for selecting, retaining, and selling investments;

(6) cost of managing the trust's investments, including brokerage fees, investment management fees, and trustee fees;

(7) the time and efforts spent by the trustee managing the investments (including time records);

(8) cumulative and/or specific gains and losses

(9) the trustee's reason for particular transactions; and

(10) the trustee's return on other portfolio's that it manages.

If the trustee uses an investment manager, the beneficiary may want to know how the trustee selected the manager, how the manager is performing relative to other and to the trustee's guidelines, other managers considered, and the manager's compensation. If the trustee invests in mutual funds, request that the trustee compare the returns on those funds with comparable funds and compare costs. If not previously requested, also ask the trustee to explain his expertise and experience in making investments. Under some circumstances, it may be appropriate to ask the trustee about his own individual portfolio to compare his performance with his own assets to his performance with the trust's assets.

An important consideration for a beneficiary is the amount of total fees being paid by the trust for investment services, including trustee fees. In some instances, these fees may be "hidden" or hard to determine. If an individual trustee has delegated investment authority, both the compensation paid to the trustee and to the investment advisor should be combined to determine the overall cost. If it is not

clear from statements, the beneficiary should ask the trustee to synthesize and disclose this information. Although there are no cases directly on point, if a trustee has delegated his investment duties, it seems logical and reasonable that his trustee fees should be adjusted. Otherwise, the trust would incur an unnecessary "double cost" for asset management.

D. Power to Adjust Between Principal and Income

If, after the beneficiary has received sufficient information and all issues regarding principal and income allocations and investment management have been resolved, the income beneficiary still believes that he is not receiving adequate distributions, the beneficiary should consider whether to ask the trustee to exercise its power to adjust to recharacterize principal as income under Trust Code Section 116.005.

Section 116.005 authorizes a trustee to adjust between principal and income if the trustee is in compliance with the prudent investor rule, the trust provides for distributions to a beneficiary by reference to the trust's "income" and the trustee cannot otherwise administer the trust impartially, based on what is fair and reasonable to all of the beneficiaries. The power to adjust specifically includes the power to allocate all or part of a capital gain to trust income. This section lists nine factors that a trustee may consider in deciding whether or how to exercise the power to adjust and prohibits a trustee from making an adjustment under certain circumstances.

A court may not question a trustee's exercise or non-exercise of the power to adjust unless the court determines that the decision was an abuse of the trustee's discretion. If a court determines that a trustee has abused its discretion, the court may place the income and remainder beneficiaries in the positions that they would have occupied if the discretion had not been abused. TEX. TRUST CODE §116.006(c). If the trustee reasonably believes that one or more beneficiaries will object to the exercise of a discretionary power, the trustee may petition the court to determine whether the proposed discretionary act will result in an abuse of the trustee's discretion. TEX. TRUST CODE §116.006(d). In such a suit, the trustee is directed to advance from the trust principal all costs incident to the judicial determination, including attorney's fees of the trustee, any beneficiary who is a party and any guardian ad litem. At the conclusion of the proceeding, however, the court may award costs and attorney's fees as the court deems to be "equitable and just" as provided in Trust Code §114.064, including awarding costs against the trust, a beneficiary and/or the trustee in its individual capacity if the court determines that the trustee's exercise of the discretionary power would have resulted in an abuse of discretion or that the trustee did not have reasonable grounds for believing that a beneficiary would object.

E. Trustee/Beneficiary Conflicts

1. Act in Best Interest of Beneficiaries

A beneficiary is entitled to have a competent, loyal and impartial trustee who is willing to act in the best interest of the beneficiary. This means that the trustee should be free of significant conflicts of interest. *Slay v. Burnett Trust, 187 S.W.2d 377 (Tex. 1945); Scott § 170; Restatement (2d) §170; Interfirst Bank Dallas, N.A. v. Risser, 739 S.W.2d 882, 888 (Tex.App.–Texarkana 1987, no writ).*

It is reasonable for a beneficiary to obtain information from a trustee regarding his experience as a trustee and in managing investments and any conflicts of interest he could have with the beneficiaries and/or the trust.

2. Receive Only Reasonable Compensation

A beneficiary is entitled to a trustee who will charge only a reasonable cost. Unless the trust instrument provides otherwise, a trustee is entitled to "reasonable" compensation from the trust for acting as trustee. TEX. TRUST CODE §114.061. The beneficiary is entitled to all information regarding compensation paid to the trustee and the basis for

its determination. Thus, a trustee should keep good records of all time spent as trustee.

If the trustee is an attorney or an accountant, it is preferable for the trustee to use outside professionals rather than his own firm. Such arrangements may raise concerns and may give rise to claims of self-dealing by a beneficiary and excessive compensation. If he does use his own firm to provide legal or accounting services, a request for copies of those statements should be made. The trustee should not be paid professional fees for actions required as a trustee, as well as a trustee fee. This would constitute a double fee. A trustee is not entitled to be paid his hourly professional fee for all actions taken with respect to the trust unless it produces a reasonable fee.

If an individual trustee has delegated investment authority to an investment advisor, it seems logical and reasonable that his trustee fees should be adjusted to avoid receiving excessive compensation.

Excessive fees may be grounds for removal. *See Lee v. Lee*, 47 S.W.3d 767 (Tex.App.–Houston [14th Dist.] 2001, writ denied) (removal of trustee was mandatory where a trustee charged excessive fees and took actions that resulted in material financial loss.)

If the trustee commits a breach of trust, the court may in its discretion deny the trustee all or part of his compensation. TEX. TRUST CODE §114.061. *See Langford v. Shamburger, 417 S.W.2d 438 (Tex.Civ.App.–Fort Worth 1967, writ ref'd n.r.e.), disapproved of on other grounds by Texas commerce Bank, N.A. v. Grizzle, 96 S.W.3d 240 (Tex. 2002).*

3. Neutral and Impartial

A trustee has a duty of impartiality, which requires the trustee to deal impartially with multiple beneficiaries. *Restatement (2d)* §183; *Bogert § 541, 612; Commercial Nat. Bank of Nacogdoches v. Hayter, 473 S.W.2d 561 (Tex.Civ.App. 1968, writ ref'd n.r.e.).* This duty requires that a trustee remain neutral (not take sides) in disputes that affect beneficiaries differently. As stated in *Cox-Rushing Greer Co. v. Richardson*, 277 S.W. 718, 721 (Tex.App.-Austin 1925):

> While a receiver may bring or defend an action which affects the estate in his hands from the viewpoint of the parties to the suit, as a whole, it is quite generally held that as between the respective parties to the litigation the receiver is an indifferent person, and orders and judgment of the court giving preference or priority, or turning over specific property to one or more of the litigants, are matters in which the receiver, as such, has no interest and must be litigated by the parties affected thereby [citations omitted]
>
> On the other hand, where the claim asserted by or against the receiver affects alike the interest of all parties to the suit in the property, the receiver is the proper party to bring or defend the action.

Thus, if litigation is required to resolve such a dispute (e.g., construction of trust language), the trustee's duty of impartiality prevents him from actively taking sides in the litigation. Although the trustee may need to file a suit for instructions or declaratory judgment suit to resolve the disputed issue, the trustee cannot advocate for the position of one beneficiary to the detriment of another beneficiary unless necessary to protect the trust. The trustee should minimize his involvement in the litigation to avoid incurring unnecessary costs, which the beneficiaries may object to or the court may not permit to be paid out of the trust.

4. Resignation

A trustee is not an indentured servant and

can always resign. If a beneficiary wants the trustee to resign but the trustee will not agree to, a beneficiary with legitimate concerns about the trustee should closely scrutinize all of the trustee's actions, request or inspect as much information as possible, and document all complaints to the trustee. Eventually, the trustee will decide to resign, the beneficiary will gather sufficient evidence to support a removal action, or the beneficiary will have to become resigned to the trustee. In the author's experience, regardless of the good faith and best intentions of any trustee, these types of situations rarely end well for the trustee.

F. Resistant/Uncooperative Trustee

If the trustee refuses the beneficiary's requests and litigation appears likely, the beneficiary should first consider implementing the following steps.

1. Efforts to Resolve Without Litigation

If the trustee fails to respond to initial requests for information or specific actions, a written follow up request that is more demanding and specific as to the beneficiary's legal rights and the trustee' duties should be made and should contain a deadline for compliance. A meeting with the trustee also should be considered to discuss the requests and/or disputed. Bona fide efforts should be and documented in detail made to attempt to resolve disputes with the trustee in an attempt to avoid the high cost of trust litigation, put the trustee on notice so that he has an opportunity to act, and to protect the beneficiary from later accusations of instigating controversy, and to limit the trustee's future justifications or defenses. If the trustee provides requested information and possible problems or concerns are detected, the beneficiary should identify the specific problems and request specific additional information or action from the trustee. The more extensive the efforts of the beneficiary to avoid litigation and to act reasonably, the better the chances of prevailing on breach of fiduciary claims and in preventing the trustee from recovering attorney's fees out of the trust incurred in subsequent litigation.

Hostility between a trustee and a beneficiary is not, by itself, a sufficient ground for removal of the trustee. It must be further shown that the trustee's hostility does or will affect his performance as trustee. *Akin v. Dahl*, 661 S.W.2d 911 (Tex. 1983); cert. denied 466 U.S. 938 (1984). The Court will not remove a trustee based on hostility created by the beneficiary in order to effectuate the removal. *Id.*

2. Build a Litigation File

While attempting in good faith to resolve disputes, the beneficiary should be building a "litigation file" that reflects all efforts made to obtain information and resistance encountered from the trustee. All communications should be well documented and carefully constructed to portray the beneficiary as reasonable, fair and cooperative and to chronicle all events. The beneficiary should not send threatening or abusive correspondence, or make unreasonable and unjustified demands. Any hostility by the trustee toward the beneficiary should be well-documented. In preparing all correspondence (including emails), it should be presumed that it will be read by a judge or jury. The litigation file should include any evidence to support potential claims for a breach of fiduciary duty of disclosure, other breach of fiduciary duty claims, removal of trustee, actual and/or punitive damages, avoidance of an exculpatory clause, objections to payment of the trustee's legal fees by the trust, disgorgement of the trustee's fees, hostility, incompetence, and a limitation on excuses, justifications and defenses for the trustee.

The possibility of seeking punitive damages, avoiding an exoneration clause, or requesting fee disgorgement in an action for breach of fiduciary duty of disclosure should be considered. If the trustee may have violated these standards of conduct, documentation should be gathered and correspondence should be geared to reflect and support such claims.

a. Punitive Damages

Punitive damages are available in Texas for breach of fiduciary duty when the fiduciary commits a wilful, 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 the punitive damages. *Risser* at 907; *McLendon v. McLendon*, 862 S.W.2d 662 (Tex.App.–Dallas 1993, writ denied); *Villarreal v. Elizondo*, 831 S.W.2d 474 (Tex.App.–Corpus Christi 1992, no writ). *See also Transportation Insurance Company v. Moriel*, 879 S.W.2d 10 (Tex. 1994) for the standards governing imposition of punitive damages in the context of bad faith insurance litigation.

b. Unenforceable Exoneration Clause

Under Section 114.007 of the Trust Code, an exoneration clause contained in a trust instrument is unenforceable for a breach of trust committed in bad faith, intentionally or with reckless indifference to the interest of a beneficiary. *See Neuhaus v. Richards*, 846 S.W.2d 70 (Tex.App.–Corpus Christi 1992, *jmt. set aside by agrmt.*, 871 S.W.2d. 182); *Interfirst Bank Dallas v. Risser*, 739 S.W.2d 882 (Tex.App.–Texarkana 1987, no writ).

(1) Bad Faith

Bad faith, in a trustee relationship, is properly defined to mean "acting knowingly or intentionally adverse to the interest of the trust beneficiaries" and with an "improper motive." *See Interfirst Bank Dallas, N.A. v. Risser,* 739 S.W.2d 882, 898 (Tex.App. – Texarkana 1987, no writ) (disapproved of by *Texas Commerce Bank, N.A. v. Grizzle,* 96 S.W.3d 240, 249 (Tex. 2002) on other grounds). A finding of bad faith requires some showing of an improper motive. *See King v. Swanson,* 291 S.W.2d 773, 775 (Tex.Civ.App. – Eastland 1956, no writ). Improper motive is an essential element of bad faith. *See Ford v. Aetna Insurance Company,* 394 S.W.2d 693 (Tex.Civ.App. – Corpus Christie 1965, writ ref'd n.r.e.).

(2) Good Faith

Texas recognizes a standard of good faith that is in part subjective and in part objective. *See Lee v. Lee,*47 S.W.2d 767, 795 (Tex.App. – Houston [14th Dist.] 2001, pet. denied). A fiduciary acts in good faith when he or she: (1) subjectively believes his or her defense is viable, and (2) is reasonable in light of existing law. *Id.*

(3) Gross Negligence

Gross negligence means more than momentary thoughtlessness, inadvertence, or error of judgment; it means such an entire want of care as to establish that the act or omission was the result of actual conscious indifference to the rights, safety, or welfare of the person affected. *See Transp. Ins. Co. v. Moriel,* 879 S.W.2d 10, 20 (Tex. 1994). An act or omission that is merely thoughtless, careless, or not inordinately risky cannot be grossly negligent. *Id*. at 22. Only if the defendant's act or omission is unjustifiable and likely to cause serious harm can it be grossly negligent. *Id.* Although gross negligence does refer to a different character of conduct than ordinary negligence, a party's conduct cannot be grossly negligent without being negligent. *See Travino v. Lightning Laydown, Inc.,* 782 S.W.2d 946, 949 (Tex.App. – Austin 1990, writ denied). Gross negligence involves proof of two elements:

* Viewed objectively from the actor's standpoint, the act or omission must involve an ***extreme degree of risk***, considering the probability and

magnitude of the potential harm to others. "Extreme risk" is not a remote possibility of injury or even a high probability of minor harm, but rather the likelihood of serious injury to the plaintiff; and,

* The actor must have actual, subjective awareness of the risk involved, but nevertheless proceed in conscious indifference to the rights, safety, or welfare of others. Ordinary negligence rises to the level of gross negligence when it can be shown that the defendant was aware of the danger but his acts or omissions demonstrated that he did not care to address it. *See Louisiana-Pacific Corp. v. Andrade,* 19 S.W.3d 245, 246-47 (Tex. 1999). *See Mobil Oil Corp. v. Ellender,* 968 S.W.2d 917, 921 (Tex. 1998) (*citing Moriel,* 879 S.W.2d at 23 (Tex. 1994).

c. Trustee's Fee Disgorgement

In removing a trustee, a court may deny part or all of the trustee's compensation, including disgorgement of fees. TEX. TRUST CODE 113.082. Disgorgement of a trustee's fees also may be available for a mere breach of fiduciary duty, even if the fiduciary is not removed and even if the beneficiary is not damaged. *See Burrow v. Arce, 997 S.W.2d 229, 233 (Tex. 1999)*.

3. Informal Discovery

If it appears that litigation may be likely, there may be an opportunity to obtain pre-litigation discovery based on the trustees duty of disclosure. This approach can be helpful to avoid cumbersome and expensive formal discovery under the Texas Rules of Civil Procedure. The fiduciary duty of full disclosure operates before and after litigation has been filed and is in addition to any obligations of disclosure imposed by the "discovery" provisions of the Texas Rules of Civil Procedure. *Huie v. DeShazo*, 922 S.W.2d 920 (Tex. 1996); In re, 2004 WL 88872 (Tex.App. – Amarillo) (not designated for publication). The existence of strained relations between the parties did not lessen the fiduciary's duty of full and complete disclosure. *Texas Bank & Trust Co. v. Moore*, 595 S.W.2d at 508; *Johnson v. Peckham*, 132 Tex. 148, 151-52, 120 S.W.2d 786, 788 (1938).

The beneficiary may want to request disclosure of substantial information from the trustee based on the trustees duty of disclosure to request all documentation that may be relevant to the disputes. The scope of obtaining information under the duty of disclosure is not limited by what information appears "reasonably calculated to lead to the discovery of admissible evidence" per TRCP 192.3, there is less opportunity to object to the requested information, there are no limits on the number of requests that can be made, it may be possible to force the trustee to compile certain information (e.g., calculate the net return on investment of the trust portfolio for several years). In addition, if the trustee fails to comply with the demand for information, there may be a separate claim for breach of fiduciary duty of disclosure. In general, the beneficiary may want to demand the right to examine the books and records of the trust and any specific documentation that may be needed.

If the trustee refuses the demand for information, the beneficiary's remedy is to file a lawsuit to compel the trustee to answer the information under Texas Trust Code 115.001. The lawsuit should allege breach of fiduciary duty to disclose and seek legal fees from the trustee individually and also ask the court to order the trustee to pay his legal fees individually. This more narrow suit may result in greater cooperation and possibly avoidance of a broader and more expensive suit.

If difficulties in obtaining disclosure are encountered, this may be an opportunity to conduct pre-litigation informal discovery. This option may

help lower the expense of formal discovery in the event of litigation, assist the plaintiff evaluating and preparing his case. If information is successfully obtained, it could also eliminate the need for litigation. If the trustee fails or refuses to provide the requested information within a reasonable time, then an action can be maintained pursuant to TEX. TRUST CODE §115.001 to require the trustee to furnish the information and to pay attorney's fees and costs of the suit pursuant to TEX. TRUST CODE § 114.064.

4. Non-Judicial Trust Division or Combination

Trust Code Section 112.057 allows a trustee, without court intervention, to divide a trust into two or more separate trusts, or to combine two or more trusts into a single trust, if "the result does not impair the rights of any beneficiary or adversely affect achievement of the purposes of the original trust." Prior notice must be given to all beneficiaries. There may be circumstances where a beneficiary would desire or oppose such a separation or combination. E.g., to create a new trust containing or deleting administrative powers in which to merge the original trust. If requested by a beneficiary, the trustee should consider the merits. If the trustee refuses, the beneficiary should ask the trustee to provide a written explanation for its decision. If all of the beneficiaries agree and sign a Family Settlement Agreement, the trustee may have no standing to complain. See discussion regarding Family Settlement Agreements at II.A.3. *supra*.

5. Non-Judicial Termination of Uneconomic Trust

A trustee of a trust with assets valued at less than $50,000 may terminate the trust without judicial involvement if the trustee concludes "after considering the purpose of the trust and the nature of the trust assets that the value of the trust property is insufficient to justify the continued cost of administration." Prior notice must be given to current distributees and those who would be distributees if the trust were to terminate. TEX. TRUST CODE §112.059(a). If the trustee terminates the trust, the assets are to be distributed by the trustee "in a manner consistent with the purposes of the trust."

6. "Voluntary" Resignation of Trustee and Selection of Successor

A trustee may resign in accordance with the terms of the trust or may petition a court for permission to resign. TEX. TRUST CODE §113.081. If the relationship between the trustee and the beneficiary deteriorates to the point that the trustee cannot effectively and fairly administer the trust for the benefit of all the beneficiaries, the beneficiary may request that the trustee resign. This is another opportunity to build a litigation file by putting the resignation request in writing and detailing the basis for the request.

7. Mediation/Arbitration

In an effort to avoid costly trust litigation, pre-suit mediation and/or arbitration may be options to consider. Use of these procedures prior to initiating litigation could be a cost effective method of resolution. There is no Texas law specifically addressing whether an arbitration clause may be included in a trust agreement. *But see* TEX. TRUST CODE §111.0035 (trust may not limit . . . power of court, in the interest of justice, to take action or exercise jurisdiction, including power to . . . exercise jurisdiction under Section 115.001). However, there is no reason that the trustee and beneficiaries could not agree to settle their disputes through arbitration rather than traditional litigation.

8. Consider No Contest Clause

Before embarking on any trust litigation, the beneficiary must carefully consider the terms of any no contest or forfeiture clause. Although historically not as common as in wills, more trusts are now including in no contest clauses. The beneficiary must evaluate whether any action he may take could be considered a violation of its provisions. Texas has enforced broad no contest clauses. *See Perry v. Rogers,* 114 S.W. 897, 899 (Tex.Civ.App. 1908, no writ); *Massie v. Massie,* 118 S.W. 219, 220 (Tex.Civ.App. 1909, no writ); 74 TEX. JUR. 3D WILLS §255 (1990); Hopwood, *In*

Terrorem and No Contest Clauses, 1999, Advanced Estate and Probate Planning Course (State Bar of Texas 1999). If the settlor is deceased and the trust beneficiary also is a beneficiary under the settlor's will, the will also should be reviewed for an in terrorem clause that could include challenges to a trust and visa versa.

No contest clauses are strictly construed by Texas courts and will not be construed to allow a trustee to breach his fiduciary duties with impunity. *See Badouh v. Hale,* 22 S.W.3d 392 (Tex. 2000); *McClendon v. McClendon,* 862 S.W.2d 662, 678 (Tex.App. – Dallas 1993, writ denied), *disapproved on other grounds by, Dallas Market Center Dev. Co. v. Liedeker,* 958 S.W.2d 382 (Tex. 1997); *Gunter v. Poe,* 672 S.W.2d 840, 842 (Tex.App. – Corpus Christi 1984, writ ref'd n.r.e.). The court should only find a breach of a no contest clause when the acts of the parties come within the clause's express terms. *See Gunter v. Poe,* 672 S.W.2d at 842; *Conte v. Conte,* 56 S.W.3d 830 (Tex.App. – Houston [1st Dist.] 2001, no pet. h.).

Like the Probate Code, the Trust Code now contains a good faith statutory exception for forfeiture clauses in wills. TEXAS TRUST CODE § 112.038 (effective 9/1/09). These provisions are intended to clarify existing law, but pre-existing law was not clear on whether a good faith exception existed under Texas common law. *See Hammer v. Powers,* 819 S.W.2d 669 (Tex.App. – Fort Worth 1999, no writ) (grant of summary judgment not error where contestants failed to plead good faith and probable cause for will contest). *See also Calvery v. Calvery,* 55 S.W.2d 527, 530 (Tex. Comm. App. 1937, opinion adopted); *Gunter v. Pogue,* 672 S.W.2d 840, 842-43 (Tex.App. – Corpus Christi 1984, writ ref'd n.r.e.); *Sheffield v. Scott,* 662 S.W.2d 674, 676 (Tex.App. – Houston [14th Dist.] 1983, writ ref'd n.r.e.); *Hodge v. Ellis,* 268 S.W.2d 275, 287 (Tex. Civ.App.– Fort Worth 1954), *aff'd in part, rev'd in part,* 277 S.W.2d 900 (Tex. 1955).

9. Litigation

a. Types of Actions and Remedies

There are numerous types of actions that the issues described above may give rise to, including a suit to compel an accounting under TEXAS TRUST CODE § 113.152, a suit to remove a trustee under TEXAS TRUST CODE §113.082, a suit to compel proper distributions and/or disclosure, a suit to redress or prevent future breaches of fiduciary duties, a suit for declaratory judgment under TEX. CIV. PRAC. & REM CODE § 37.005 to construe the trust or to resolve disputed issues, a petition for instructions under TEXAS TRUST CODE § 115.001, a petition for judicial modification or termination of a trust under TEXAS TRUST CODE § 112.054.

TRUST CODE SECTION 114.008 provides the following remedies for a breach of trust that has occurred or "might occur":

(1) compel the trustee to perform the trustee's duty or duties;

(2) enjoin the trustee from committing a breach of trust;

(3) compel the trustee to redress a breach of trust, including compelling the trustee to pay money or to restore property;

(4) order a trustee to account

(5) appoint a receiver to take possession of the trust property and administer the trust;

(6) suspend the trustee;

(7) remove the trustee as provided under Section 113.082;

(8) reduce or deny compensation to the trustee;

(9) subject to Subsection (b), void an act of the trustee, impose a lien or a constructive trust on trust property, or trace

trust property of which the trustee wrongfully disposed and recover the property of the proceeds form the property; or

(10) order any other appropriate relief.

b. The Beneficiary's Dilemma

Fiduciary law emphasizes the strict legal standards to which trustees are held in order to protect the rights and interests of the beneficiaries. Trust and estate attorneys are familiar with Justice Cardozo's famous description of the extraordinary standard applicable to a fiduciary as "something stricter than the morals of the marketplace. Not honesty alone, but the punctilio of an honor the most sensitive." *Meinhard v. Salmon*, 249 N.Y. 458, 164 N.E. 545-546 (1928). Despite the undeniable application of these extremely high duties intended to protect beneficiaries from a trustee's misconduct, intentional or unintentional, a beneficiary's ability to enforce these rights is often a difficult challenge. The trust assets are not available to the beneficiary to aid in the efforts to enforce the rights and protect the trust assets. Instead, the trustee – the alleged wrongdoer – controls the assets and can access them to resist efforts to compel his compliance with the legal standards. Thus, a beneficiary who believes that the trustee is not properly performing his responsibilities and is depriving the beneficiary of his rightful financial resources, is faced with a serious dilemma. In order to seek relief, the beneficiary must not only deplete his personal funds for legal fees, but also risk the depletion of trust funds for the trustee's legal fees (which reduce future benefits). Even if the beneficiary is successful on the merits of his claim, he may be worse off financially due to the litigation costs unless the trustee is ultimately personally responsible for all litigation costs.

The award of attorney's fees and costs in trust litigation is strictly within the discretion of the court. Trust Code Section 114.064 provides that in any trust proceeding, the court may make an award of costs and reasonable and necessary attorney's fees "as may seem equitable and just." Section 114.064 is not a prevailing party statute. Thus, an award of attorney's fees under Section 114.064 is not dependent on a finding that the party "substantially prevailed." *Hachar v. Hachar,* 153 S.W.3d 138, 142-143 (Tex.App. – San Antonio 2004, no pet.). The reasonable and necessary requirements for attorney's fees are questions of fact to be determined by the fact finder, but the equitable and just requirements are questions of law for the trial court to decide. *Id. See Sammons v. Elder*, 940 S.W.2d 276 (Tex.App.–Waco 1997, writ denied) (court refused to award attorney's fees to either side).

Under Trust Code Section 113.082, if a trustee is removed for materially violating or attempting to violate the terms of the trust, which results in material financial loss to the trust, or the trustee fails to make a required accounting, or for "other cause," the court may deny part or all of the trustee's compensation. If a trustee is removed for cause, he should not be entitled to recover his attorney's fees out of the trust and may be ordered to personally bear the beneficiary's attorney's fees. RESTATEMENT §188.4; *Jernigan v. Jernigan*, 677 S.W.2d 137 (Tex.App.–Dallas 1984, no writ) (where one of three beneficiaries successfully sued the trustee for breach of trust, the trial court acted improperly in ordering the entire trust corpus and accumulated income paid to the plaintiff's attorney's as their fee); *Tindell v. State,* 671 S.W.2d 691, 693 (Tex.App.–San Antonio 1984, writ ref'd n.r.e.) (estate should not be charged with executor's legal expenses if executor's conduct is at the root of the litigation. Where litigation is caused by the trustee's misconduct, the trustee is not entitled to recover attorney's fees out of the trust. 76 AM. JUR.2D TRUSTS §673. *See also Tindall v. State*, 671 S.W.2d 691, 693 (Tex.App.–San Antonio 1984, writ ref'd n.r.e.) ("it is thus apparent that when the fiduciary's omission or malfeasance is at the root of the litigation, the estate will not be required to reimburse the fiduciary for his or her attorneys' fees. Such fees are not necessarily incurred in connection with the management of the estate."); *In Re: Higginbotham's Estate*, 192 S.W.2d 285, 290 (Tex.Civ.App.–Beaumont 1946, no writ); and *In Re: Estate of Washington*, 289 S.W.3d 362 (Tex.App.–Texarkana 2009, pet. denied)(administratrix who was removed not

entitled to recover attorney's fees from the estate incurred by her to contest her removal. Her removal as administratrix involved neither the preservation or safekeeping of the estate, nor the management of the estate as provided in PROBATE §242.) However, if the trustee successfully defends a suit for breach of fiduciary duty or removal, his fees are properly payable out of the trust. RESTATEMENT §188.4.

If a beneficiary is successful in a suit to compel an accounting, the court may award all or part of the costs of court and all of the suing beneficiary's reasonable and necessary attorney's fees and costs against the trustee in the trustee's individual capacity or in the trustee's capacity as trustee." TEX. TRUST CODE §113.151(a).

Trust instruments often authorize a trustee to hire professionals and to pay them reasonable fees out of trust assets. Trust Code Section 114.063 authorizes a trustee to pay out of trust assets expenses incurred while administering or protecting the trust. Trustees often try to rely on these provisions as support to pay their attorneys' fees in litigation filed by a beneficiary for alleged wrongdoing by the trustee. Although no Texas case has ruled directly on this question, a strong argument can be made that neither of these provisions authorizes a trustee to pay its attorney's fees incurred in connection with such trust litigation because the fees are being incurred to protect the trustee solely in his individual capacity, not the trust. The attorney's fees for all parties in litigation against a trustee, including the trustee, should be awarded by the court upon conclusion of the litigation under Section 114.064 (or other statute claimed to authorize fee in the suit).

c. TRO/Temporary Injunction

One of the most effective tools in representing a beneficiary-plaintiff in a suit against the trustee is to seek a temporary restraining order and temporary injunction prohibiting the trustee from using trust assets to pay the trustee's legal fees during the litigation, at least not without a prior court order. Trust Code Section 115.001(c) (enacted in 2005) specifically authorizes a court to "intervene in the administration of a trust to the extent that the court's jurisdiction is invoked by an interest party or as otherwise provided by law. Trust Code Section 114.008 (2) specifically provides for injunction as a remedy for breach of trust that "has occurred or might occur." In *183/620 Group Joint Venture v. SPF Joint Venture,* 765 S.W.2d 901 (Tex.App. – Austin 1989, writ dism'd w.o.j.), the court of appeals upheld the trial court's temporary injunction prohibiting the defendants from using funds held by them as fiduciaries for the payment of attorneys fees and expenses in defending the breach of fiduciary lawsuit.

Seeking a temporary restraining order and temporary injunction also presents an excellent opportunity to obtain expedited and supervised discovery at the hearing on the temporary injunction that must take place within 14 days. TEX. R. CIV. P. 680. It may also be the only way to protect the beneficiary and the trust assets from further damage in the event the fiduciary will not be able to adequately respond in damages.

The procedural requirements for a temporary restraining order and temporary injunction are provided in Texas Rules of Civil Procedure 680-693. The trial court has broad discretion in determining whether to grant or deny a temporary injunction. *Transport Company of Texas v. Robertson Transports,* 261 S.W.2d 549 (1953). At the temporary injunction hearing, the only issue before the trial court is whether the applicant is entitled to preservation of the status quo of the subject matter of the suit pending trial on the merits. *Davis v. Huey,* 571 S.W.2d 859 (Tex. 1978). An order granting a temporary injunction will not be reversed on appeal absent a clear abuse of discretion. *State v. Southwestern Bell Telephone Co.,* 526 S.W.2d 526 (Tex. 1975). To be entitled to a temporary injunction, the party must plead and prove a probable right to recovery and a probable injury without such temporary equitable relief. *Transport Company of Texas v. Robertson Transports,* 261 S.W.2d at 551. The party is not required to prove that he will finally prevail in the

litigation. *Sun Oil Company v. Whitaker,* 424 S.W.2d 216 (Tex. 1968).

Injunctive relief generally will not be granted unless the applicant has shown that irreparable injury will result if such relief is not afforded and that the applicant has no adequate remedy at law for damages which may result pending an outcome of the litigation. The test for determining whether an existing remedy is adequate is whether such remedy is as complete and as practical and efficient to the ends of justice and its prompt administration as is equitable relief. *Brazos River Conservation & Reclamation District v. Allen,* 171 S.W.2d 847 (Tex. 1943). No adequate remedy at law exists if damages are incapable of calculation or if the defendant is incapable of responding in damages.

However, most Texas cases have held that in a fiduciary case, the beneficiary is not required to show that he has an inadequate remedy at law. *183/620 Group Joint Venture v. SPF Joint Venture, supra,* at 903-904, and authorities cited therein. Since a breach of fiduciary claim is by nature an "equitable" action, even in cases where damages may be sought, if the fiduciary relationship is still continuing, the beneficiary has an equitable right to be protected from further harm. Thus, there is never an adequate remedy at law for a breach of fiduciary duty claim. However, at least one case has required a beneficiary to show that no adequate remedy at law for damages exists. *See Ballenger v. Ballenger,* 694 S.W.2d 72 (Tex.App. – Corpus Christi 1985, no writ)(holding that trust beneficiary failed to show irreparable injury or the absence of an adequate remedy at law to enjoin trustees from making distribution to themselves as beneficiaries because any damages that might ensue were capable of exact calculation and the evidence did not show that trustees were insolvent or unable to respond in damages for any wrongful distributions made by them from the trust in question).

Further, in a fiduciary case, the usual burden of establishing a "probable right to recover" before the court will grant a temporary injunction does not apply if the gist of the complaint is "self-dealing". In a fiduciary self-dealing action, the "presumption of unfairness" attaches to the transactions of the fiduciary shifting the burden to the defendant to prove that the plaintiff will not recover. If the presumption cannot be rebutted as a matter of law at the temporary injunction state, then the injunction should be granted since the plaintiff, by simply presenting a *prima facie* case of the existence of a fiduciary relationship and a probable breach of that duty has adduced sufficient facts tending to support his right to recover on the merits. *Cf. Camp v. Shannon,* 348 S.W.2d 517, 519 (Tex. 1961); and, *Jenkins v. Transdel Corp.,* 2004 WL 1404364 (Tex.App. – Austin 2004, no pet.)(exculpatory provision would not defeat showing of "probable right to recover" where some evidence that agreement including the clause was induced by fraud).

d. Receiver

Section 64.001(a)(6) of the Texas Practice and Remedies Code provides that a receivership may be created by a court in any case in which "a receiver may appointed under the rules of equity." Receivers have been appointed to take charge of trust assets during litigation. *Pfeiffer v. Pfeiffer,* 394 S.W.2d 679 (Tex.App. – Houston 1965, writ dism'd); *Temple State Bank v. Mansfield,* 215 S.W. 154 (Tex.Civ.App.– Galveston 1919); *Smith v. Smith*, 681 S.W.2d 793, 795 (Tex.App.-Houston [14th Dist.] 1984, no writ). A receiver also may be appointed in an action between persons "jointly owning or interested in any property or fund."

The receivership must be ancillary or auxiliary to some right that constitutes an independent cause of action. *See Manning v. State,* 423 S.W.2d 406, 410 (Tex.Civ.App. – Austin 1967, writ ref'd n.r.e.); *Pelton v. First Nat'l Bank of Angelton,* 400 S.W.2d 398, 401 (Tex.Civ.App. – Houston 1966, no writ); *Greenland v. Pryor,* 360 S.W.2d 423, 425 (Tex.Civ.App. – San Antonio 1962, no writ).

The rules of equity allow a receivership only when it is shown to be reasonably necessary for

preservation of property involved in litigation, and for the protection of the rights of persons having claims against it. The party seeking receivership must have an interest, or a probable interest, in the property in question. It must also be shown that the property or fund is in danger of being lost, removed, or materially injured, if left in the hands of the person in possession of the property. Finally, there must be no other remedy available to the petitioner that is adequate and complete.

e. Auditor

Texas Rules of Civil Procedure 172 provides that "when an investigation of accounts or examination of vouchers appears necessary for the purpose of justice between the parties to any suit, the court shall appoint an auditor or auditors to state the accounts between the parties and to make report thereof to the court as soon as possible . . .". To request an audit, a specific motion or application should be filed with the court with the claims to be submitted to the auditor spelled out in as much detail as possible.

The circumstances in which an audit will be ordered depend on the facts of each individual case. See, e.g., *Robson v. Jones,* 33 Tex. 324, 328 (1870)(auditor unnecessary where no particular complications apparent on face of account); *Ellison v. Keese,* 25 Tex. 84, 91 (Supp. 1860)(court found no reason for appointment of auditor in will contest); *Gifford v. Gabbard,* 305 S.W.2d 668, 672-73 (Tex. Civ. App. – El Paso 1957, no writ)(no necessity for auditor where all pertinent documents are in evidence and books are in simp form); *Peters v. Brookshire,* 195 S.W.2d 181, 186-87 (Tex. Civ. App. – Ft. Worth 1946, writ ref'd n.r.e.)(no reversible error in failing to appoint auditor where books did not appear to be complicated and private auditors had access to books); but see, *Dwyer v. Kaltayer,* 68 Tex. 554, 5 S.W. 75, 77 (1887)(audit proper where estate large and settlement embraced results of testator's business); *Whitaker v. Bledsoe,* 34 Tex. 401 (1870-71)(partnership accounting necessary to assist court); *Hunt v. Ullibari,* 35 S.W. 298 (Tex. Civ. App. 1896, no writ)(dispute involving examination or revision of complicated account).

The granting or refusal of an audit is within the discretion of the trial court, and its decision will be reversed on appeal only when gross abuse of discretion is shown. *H.E. & W.T. Ry. Co. V. Snelling,* 59 Tex. 116, 123 (1883); *Robson,* 33 Tex. at 328; *Padon v. Padon,* 670 S.W.2d 354, 360 (Tex. App. – San Antonio 1984, no writ).

Once the auditor files its report, the parties must file exceptions and objections to the auditor's report within thirty (30) days. Tex. R. Civ. Proc. 172. Failure to file exceptions to the auditor's report may result in a waiver of the right to introduce evidence contrary to the report at the time of trial. *Sanchez v. Jary,* 768 S.W.2d 933 (Tex. App. – San Antonio 1989, no writ). *See also, Burns v. Burns,* 2 S.W.3d 339 (Tex. App. – San Antonio, 1999).

APPENDIX A

PRINCIPAL AND INCOME ALLOCATIONS UNDER TEXAS TRUST CODE

Trust Code §	Income	Principal
Receipts:		
116.151	Funds received from entity	Other property received from entitiy
	Net short-term capital gain dividends	Distributions for liquidation or redemption Capital gain dividends from mutual funds or REIT (net LTCG over net STCL)
		Reinvested dividends.
116.161		Proceeds from sale/exchange of a principal asset.
		Transfers to trust by settlor during life or from estate (except as otherwise required).
		Payments received as beneficiary of life insurance or annuity (except as otherwise required).
		Income received during period where no permissible income beneficiary exists.
116.162	Rent	Refundable rent deposit
116.163	Interest on debt	Principal payments
116.164	Insurance policy dividends	Life or casualty insurance proceeds
	Insurance proceeds for loss of income or profits.	
116.174	Mineral interests "allocated equitably" Allocations are presumed equitable if equal to depletion deduction under the IRC §611: 85% May continue allocation under prior law under prior law for interests	Mineral interests "allocated equitably" 15%

Trust Code §	Income	Principal
	owned on 1/1/04: 72.5%	27.5%
Disbursements:		
116.201 & 116.202	½ trustee fee	½ trustee fee
	½ investment advisory fees	½ investment advisory fees.
	½ costs of accounting that covers income and principal interests.	½ costs of accounting that covers income and principal interests.
	½ costs of judicial proceedings involving income and principal interests.	½ costs of judicial proceedings involving income and principal interests.
	Costs of judicial proceeding involving primarily income interests.	
	Ordinary expenses incurred in connection with administration, management, preservation of trust property and distribution of income, including: ordinary repairs property taxes interest	
	Casualty insurance premiums	Title insurance premiums Other insurance premiums
		Trustee fee for acceptance, distribution or termination of trust.
		Disbursements to prepare property for sale.
		Principal payments on debt
		Costs of judicial proceeding primarily relating to principal, including suit to construe trust or to protect trust or trust assets.
116.205 & 116.206*	Tax on receipts allocated to income	Tax on receipts allocated to principal
		Taxes on excess of receipts distributed from an entity.

Trust Code §	**Income**	**Principal**
Transfers between income and principal:		
116.203 & 116.204		Reasonable amount of net cash receipts from depreciable asset (except for beneficiary's residence or during estate administration)
*Trustee may make equitable adjustments to offset shifting of economic interests or tax benefits between income and remainder beneficiaries due to tax elections or decisions		