2012 Fiduciary Litigation Update

By David F. Johnson

Introduction

- Financial institutions are routinely called upon to take fiduciary roles in managing assets.
- This role can require the fiduciary to act and file suits and it can also open the fiduciary up to potential liability.
- This presentation is intended to provide an update on current legal precedent that impacts fiduciaries.

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Burden of Proof

- When parties file suits against fiduciaries, they often are under the impression that the fiduciaries have the burden of proof.
- That is true regarding transactions between the fiduciary and client, but it is not otherwise true.

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Burden of Proof

- *Clower v. Wells Fargo Bank, N.A*.
- The beneficiaries alleged that because the bank was not named as trustee in the original trust instruments (some created decades ago), every time there was a renaming, merger at the bank level or holding company level, change in ownership of the bank, or fiduciary substitution, the bank or its predecessors had to seek court approval to remain trustee.
- Claimed bank had burden to prove up every transaction.

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Burden of Proof

- Court held that where there is "no transaction between the fiduciary and principal, there is no presumption of unfairness, and the burden of proof does not shift to the fiduciary."
- "Here, the relevant transactions involved are the transfers of trustee status between banks and/or trust companies, not between the beneficiaries and the banks/trust companies. Therefore, such burden shifting does not apply in this case."

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Arbitration Rights

- Is an arbitration clause in a trust document enforceable?
- In *Rachal v. Reitz,* the court held that arbitration is a matter of contract law, and that the trustee had the burden to establish the existence of an enforceable arbitration agreement.
- Trust document was not a contract between trustee and beneficiary, and the arbitration clause was not enforceable.

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Arbitration Rights

- Trustee filed petition for review with the Texas Supreme Court.
- On June 8, 2012, Texas Supreme Court granted the petition and oral argument is set for November 7, 2012.
- Potential amicus opportunity – no one has filed an amicus brief in this case.

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Venue

- In *In re JPMorgan Chase Bank, N.A*., parties sued a trustee over a title dispute regarding the right to develop minerals and raised claims to quiet title, for declaratory relief, and various tort claims.
- The trustee moved to transfer venue in accordance with section 115.002 of the Texas Property Code to Tarrant County, Texas because the suit was against a trustee and the trust was administered in Tarrant County.

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Venue

- Section 115.002 provides that when there is a corporate trustee, the venue of an action under section 115.001 of the Texas Property Code "shall be brought in the county in which the situs of the administration of the trust is maintained or has been maintained at any time during the four-year period preceding the date the action is filed, provided that an action against a corporate trustee as defendant may be brought in the county in which the corporate trustee maintains its principal office in this state."

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Venue

- Section 115.001 lists the actions that fall under the ambit of section 115.002.
- Section 115.001(a) lists specific subject matters, none of which applied to the bank in the case.
- Section 115.001(a-1) provides that section (a) is not exclusive and that "a *district court has exclusive and original jurisdiction over a proceeding by or against a trustee* or a proceeding concerning a trust under Subsection (1) whether or not the proceeding is listed in Subsection (a)."

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Venue

- Because the plaintiffs filed suit against a trustee, and because "[f]rom the plain wording of section 115.001, it applies to all proceedings by or against a trustee," the court granted mandamus relief and ordered that the case be transferred to Tarrant County, the location where the trust had been administered.
- Court held that Property Code provision trumped Texas Civil Practice and Remedies Code section 15.011 dealing with mandatory venue for suits that concern an interest in land.
- Corpus Christi Court holds to the contrary.

Exculpatory Clause

- Is an exculpatory clause in a trust instrument enforceable?
- In *Texas Commerce Bank v. Grizzle*, the Texas Supreme Court held that public policy as expressed by the legislature in the Trust Code allowed relieving a corporate trustee from liability for self-dealing except for what was specified in sections 113.052 and 113.053.

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Exculpatory Clause

- But since *Grizzle*, the Legislature amended the trust code.
- In *Martin v. Martin*, the court found that an exculpatory clause in the trust document was not enforceable.
- Section 111.0035(b) provides in part that the terms of a trust may not limit a trustee's duty to act in good faith and in accordance with the purposes of the trust.

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Exculpatory Clause

- Section 114.007 provides that an exculpatory clause is unenforceable to the extent that it relieves a trustee for liability for (1) a breach of trust committed in bad faith, intentionally, or with reckless indifference to the interest of the beneficiary; or (2) any profit derived by the trustee from a breach of trust.

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Exculpatory Clause

- The court of appeals held that the trustee owed the beneficiaries the fiduciary duties which, pursuant to section 111.0035 and section 114.007, could not be waived.
- The statutory changes modified the holding of *Grizzle*.
- Court affirmed on liability, but reversed on damages.
- Beneficiaries filed motion to extend time to file petition for review.

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Competence and Undue Influence

- Are findings of mental incompetence and undue influence conflicting findings?
- Historically, yes.
- In *In the Estate of Wilbur Waldo Lynch*, the court affirmed a judgment finding that a testator did not have mental capacity to execute a will and in so doing held that the issues of mental competence and undue influence were not necessarily contradictory.

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Competence and Undue Influence

- “While testamentary incapacity implies the want of intelligent mental power, undue influence implies the existence of testamentary capacity subjected to and controlled by a dominant influence or power.”
- But “weakness of mind and body, whether produced by infirmities of age or by disease or otherwise, maybe be considered as a material circumstances in determining whether or not a person was in a condition to be susceptible to undue influence.”

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Competence and Undue Influence

- The court of appeals concluded that testamentary incapacity and undue influence are not necessarily mutually exclusive and that one (incapacity) may be a factor in the existence of the other (undue influence).
- The court held that the expert was not precluded from opining on both questions, and also found that the jury's affirmative findings on both questions was not an irreconcilable conflict.

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Liability For Creating Accounts

- In *Stauffer v. Henderson,* the Texas Supreme Court held that language on a signature card did not create rights of survivorship.
- Under Texas Probate Code section 439(a), the Texas Legislature made a written agreement necessary to create a JTROS account.
- The Court found that a party could not introduce parol evidence – documents and oral communications before the account agreement was created – in an attempt to prove that the account was intended to be a JTROS account.

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Liability For Creating Accounts

- In *A.G. Edwards & Sons Inc. v. Maria Alicia Beyer,* the Court held that a customer can potentially raise a claim against a financial institution for failing to create a JTROS account.
- After a bank representative recommended that a father and daughter create a new JTROS account, they delivered all of the documentation necessary to create such an account.

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Liability For Creating Accounts

- The Bank lost the documentation and before new documents could be signed, the father fell into a coma and later died.
- The Bank paid the funds, which it held in an older account that was not a JTROS account, to the father's estate.
- The daughter sued the Bank for conversion, negligence, fraud, breach of contract, and breach of fiduciary duty.
- The jury found for the daughter and awarded her damages and attorney's fees, and the Bank appealed.

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Liability For Creating Accounts

- The Texas Supreme Court stated: "Section 439(a) does not govern [the daughter's] claim against [the bank]. [The Bank's] failure to take sufficient steps to create the JTWROS account necessary to establish [the daughter's] right of survivorship is a breach of a separate duty owed to [the daughter]."
- The Court did not specify what "duty" it was referring to, but allowed extrinsic evidence of the bank's failure to create the account.

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Liability For Creating Accounts

- In *Clark v. Wells Fargo Bank, N.A*., the court of appeals held that a bank did not tortiously interfere with inheritance rights or act with negligence with respect to CDs.
- The court distinguished *A.G. Edwards* because the claimants did not have any contractual relationship with the bank: "There is no evidence that they ever participated in the opening of the CDs or, as in Beyer, jointly executed any documents with Williams that would have given them any rights to the funds at issue."

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Liability For Creating Accounts

- In *Koonce v. First Victoria Nat'l Bank*, the court of appeals reversed a summary judgment in part and found that there was a fact issue as to whether a bank breached a contractual duty to set up a POD account where a document was signed and executed.
- Court, however, denied negligence and DTPA claims.

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Liability For Creating Accounts

- Conclusion: the *A.G. Edwards* opinion is a dangerous precedent for financial institutions.
- A fair reading of *AG Edwards* would only support a potential breach of contract claim by a customer.
- Banks doing business in Texas should make every effort to properly handle JTROS or POD account documents. Further, banks should revisit their account agreements so that defensive contractual and tort-based clauses may be implemented – such as no-prior representations clauses, arbitration clauses, damage waivers, etc.

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Bank's Duties To Borrowers

- Generally, a lender has no fiduciary duty to its borrowers.
- The relationship between a borrower and lender is usually neither a fiduciary relationship nor a special relationship.
- However, when a court sustains a special relationship between a borrower and lender, that has rested on extraneous facts and conduct, such as excessive lender control over, or influence in, the borrower's business activities.

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Bank's Duties To Borrowers

- In *Chambers v. First United Bank & Trust Company*, the court of appeals sustained a finding that the bank did not owe fiduciary duties to home equity borrowers.
- The bank filed suit to foreclose, and the borrowers filed various claims, including a claim that the bank had breached its fiduciary duties.

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Bank's Duties To Borrowers

- There was no evidence of any formal relationship between the bank and the borrowers, though a bank representative had been the trustee of the borrowers' trust.
- The court focused on whether there was an informal fiduciary duty

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Bank's Duties To Borrowers

- “A person is justified in placing confidence in the belief that another party will act in his best interest only where he is accustomed to being guided by the judgment or advice of the other party and there exists a long association in a business relationship as well as personal friendship.”
- The court held that to "impose such a relationship in a business transaction, there must be a fiduciary relationship before, and apart from, the agreement made the basis of the suit."

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Bank's Duties To Borrowers

- The borrower argued that the evidence showed that a bank representative acted as trustee for the borrower's trust and that control extended to the borrower and his business.
- The court of appeals held that even if this created a fact question on a "special relationship," it did not mean that such created a fiduciary duty (as opposed to a duty of good faith and fair dealing).
- Rather, "[i]nstead, to create a fact issue at trial regarding the existence of an informal fiduciary duty, the [borrowers] needed to offer evidence of a moral, social, domestic, or purely personal relationship of trust and confidence that existed before they obtained the 1999 loan."

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Removal of Trustee

- *Ditta v. Conte*, 298 S.W.3d 187 (Tex. 2009).
- The Supreme Court held that the four-year limitations period on suits alleging breach of fiduciary duty does not apply to the removal of a trustee. The Court stated: "The removal decision turns on the special status of the trustee as a fiduciary and the ongoing relationship between trustee and beneficiary, not on any particular or discrete act of the trustee." *Id*.

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Removal of Trustee

- "Because a trustee's fiduciary role is a status, courts acting within their explicit statutory discretion should be authorized to terminate the trustee's relationship with the trust at any time, without the application of a limitations period." *Id*.
- However, actions against a fiduciary for damages are still controlled by the statute of limitations analysis: "While the four-year limitations period proscribes whether an interested person can obtain monetary recovery from a trustee's fiduciary breach, it does not affect whether the interested person can seek that trustee's removal." *Id*.

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Removal of Trustee

- In *Ditta*, the Court expressly stated that it was not ruling upon whether the equitable defense of laches could apply and did not discuss other equitable defenses such as ratification, estoppel, and waiver.

Modifying A Trust

- In *Conte v. Ditta,* after remand the court of appeals affirmed the trial court's removal of the trustee. 312 S.W.3d 951 (Tex. App.—Houston [1st Dist.] 2010, no pet.).
- But, the court of appeals held that the trial court erred in modifying the trust in appointing a new trustee.
- The trust provided a detailed system for selecting a new trustee, and that system should have been followed.

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Modifying A Trust

- The court noted that a trial court is permitted to modify the terms of a trust if, due to circumstances not known to or anticipated by the settlor, compliance with the terms of the trust would defeat or substantially impair accomplishment of the purposes of the trust. *See* Tex. Prop. Code Ann. § 112.054(a)(2) (Vernon 2007)).

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Modifying A Trust

- But the trial court does not have unfettered discretion to modify a trust in any way it chooses. If the court finds that modification is proper, the court must exercise its discretion to modify "in the manner that conforms as nearly as possible to the intention of the settlor." *Id*. at § 112.054(b).
- Even though the parties under the trust instrument could not reappoint the trustee that had just been removed, “the court should have allowed [the beneficiaries] to select a successor trustee and simply modified the Trust by restricting their choice of successor trustee to someone whom it had not previously removed.”

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Administrator's Claim To Funds In Joint Account Failed

- *In the Estate of Abernethy,* in a suit by an administrator for funds in joint accounts, the court held in May of 2012 that an accountant and beneficiary of the accounts did not owe fiduciary duties to the decedent where there was no evidence that the decedent was accustomed to being guided by the accountant's judgment and advice in legal, financial, and accounting matters.

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Interesting Procedural Issues

- One court held that a trial court did not have any jurisdiction to enter a judgment against a trustee where the trustee was only served in her individual capacity.
- One court held that a trustee has the right to represent himself in his individual capacity but not in his capacity as trustee.

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Conclusion

- Fiduciary litigation is an ever changing field.
- The law expands and contracts depending on the mood of the Legislature and judiciary.
- The author hopes that this update provides assistance to financial institutions that choose to take on fiduciary duties.

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