



Texas Fiduciary Litigation Update 2012-2013

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.

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.
- The court of appeals held that a trust document was not a contract between a trustee and a beneficiary and did not enforce the arbitration clause.

Arbitration Rights

- The trustee filed petition for review with the Texas Supreme Court.
- On June 8, 2012, the Texas Supreme Court granted the petition and held oral argument on November 7, 2012.
- The Supreme Court reversed the court of appeals.

Arbitration Rights

- The Court did so for two primary reasons: 1) the settlor determines the conditions attached to her gifts, which should be enforced on the basis of the settlor's intent; and
- 2) the issue of mutual assent can be satisfied by the theory of direct-benefits estoppel, so that a beneficiary's acceptance of the benefits of a trust constitutes the assent required to form an enforceable agreement to arbitrate.

Arbitration Rights

- The Texas Arbitration Act provides that a “written agreement to arbitrate is valid and enforceable ...”
- Agreement can be something less than a contract.
- The Court defined it as “a mutual assent by two or more persons.”

Arbitration Rights

- Because the plaintiff had accepted the benefits of the trust for years and affirmatively sued to enforce certain provisions of the trust, the Court held that the plaintiff had accepted the benefits of the trust such that it indicated the plaintiff's assent to the arbitration agreement.

Arbitration Rights

- Why would a party want an arbitration clause?
- What are some drafting tips to help limit some of the negative aspects of arbitration?

Trust Construction

- In *Woodham v. Wallace*, parents executed trust documents and named their three children as beneficiaries.
- The parents later amended the trust and stated that they intentionally made no provision in the trust agreement for the use or benefit of a daughter.
- After the parents died, the excluded daughter petitioned the court to construe the will and trust to include benefits to her.

Trust Construction

- The court's primary objective in construing a trust is to determine the intent of the maker.
- If a trust is susceptible to a certain or definite meaning or interpretation, the court will conclude it is unambiguous and construe it as a matter of law.
- The court should harmonize all provisions and construe the instrument to give effect to all provisions so that no provision is rendered meaningless.
- To create a trust by a written instrument, the settlor must identify the beneficiary, the res, and the trust purpose.

Trust Construction

- The omitted daughter argued that the trust failed because its beneficiaries and purpose could not be identified with reasonable certainty.
- "The trust is subject to only one reasonable interpretation: after naming Woodham as a surviving child of Dewey and Edna, the trust explicitly and unambiguously excludes Woodham as a beneficiary."
- The purpose of the trust (to support the settlor's descendants) was the main purpose of the trust, but it was not the sole or exclusive purpose of the trust.

Trust Construction

- In *Duncan v. O'Shea*, John O'Shea executed a will providing for the establishment of two trusts upon his death: a marital deduction trust and a family trust.
- A daughter (contingent beneficiary) claimed that the trustee was distributing too much money to herself.
- The court noted that this assertion overlooked testimony that, while they were married, John was generous with his gift giving.
- Furthermore, notwithstanding her income sources, considering her expenses, the trustee lived on less after John's death than before.

Trust Construction

- For a "support" and "maintenance" trust provision, the trustee is obligated to make his or her decision whether to authorize a distribution after considering the following factors: (1) the size of the trust estate; (2) the beneficiary's age, life expectancy, and condition of life; (3) his or her present and future needs; (4) the other resources available or the beneficiary's individual wealth; and (5) his present and future health, both mental and physical.

Trust Construction

- Regarding the daughter's conversion claim, the court found that she lacked standing to assert that claim.
- Claim for conversion failed because there was no evidence that she had possession of, or was entitled to possession of, the trusts' assets.
- Removal claim failed for failure to plead it (even though requested at trial).

Trust Construction

- In *Estate of Richardson*, a remainder beneficiary of a trust filed a declaratory judgment action to declare that the trust would terminate five years after its creation.
- The court held that the amount of attorney's fees that were "reasonable and necessary" presented a question of fact, but determining the amount that was "equitable and just" presented a question of law for the court's sound discretion.
- Affirmed denial of fees to successful party.

Trust Construction

- In *Vela, Jr. v. GRC Land Holdings, Ltd.*, a settlor created a revocable trust naming all four of her children as equal beneficiaries.
- Settlor then transferred real estate into the trust via a special warranty deed that stated that the settlor was transferring the property to the trustee “forever.”
- The trustee later amended her trust to omit one of her children.

Trust Construction

- No specific words of art are needed to create an irrevocable trust; however, the instrument must clearly reflect the settlor's intent to make the trust irrevocable.
- The plain language of the special warranty deed did not indicate that the settlor intended to make the trust irrevocable.
- Because Section 112.051(a) of the Texas Property Code requires express language of irrevocability, the use of the term "forever" in the deed did not cause the trust to become irrevocable.
- Equitable title argument also failed.

Trust Construction

- In *Di Portanova v. Monroe*, grandparents set up eight trusts for a grandchild that had a mental disability.
- The grandchild's guardians filed suit to modify the terms of the trusts to consolidate them resulting in a savings of over \$300,000 a year.
- Other members of the family argued that by seeking the consolidation of the trusts, the guardians had caused a forfeiture of the ward's interest under the will pursuant to a no-contest or *in terrorem* clause.

Trust Construction

- No-contest clauses are designed to dissuade beneficiaries from filing vexatious litigation, particularly as among family members, that may thwart the intent of the grantor.
- A violation of a no-contest clause will be found only when the acts of the parties clearly fall within the express terms.
- Courts construe no-contest clauses to avoid forfeiture, while also fulfilling the settlor's intent.

Trust Construction

- The trial court consolidated the trusts.
- The court held that filing suit for judicial modification of the administrative terms of the trusts was not an action that was intended to thwart the settlor's intent.
- The no-contest clause did not deprive the beneficiary of a statutory right related to trust administration when such changes are not prohibited by the will.

Trust Construction

- Section 64 of the Texas Probate Code states: “A provision in a will that would cause a forfeiture of or void a devise or provision in favor of a person for bringing any court action, including contesting a will, is unenforceable if: (1) just cause exists for bringing the action; and (2) the action was brought and maintained in good faith.”
- Will be recodified in Estate's Code

Trust Construction

- In *Estate of Jones*, the dispute was whether death benefits from a variable annuity were income that would go to the wife or principal that would go to the estate.
- Section 116.164 of the Texas Property Code provides that a trustee shall allocate to principal the proceeds of a life insurance policy or other contract on which the trust or its trustee is named as beneficiary.
- The court held that Section 116.164 was persuasive authority that the death benefits were properly allocated to principal of the decedent's estate.

Trust Construction

- The court also determined that the initial character of the death benefits was not transformed by the subsequent purchase of other annuities or the transfer of the annuities from the estate to a trust.
- Section 116.161(2) of the Texas Property Code requires that "money or other property received from the sale, exchange, liquidation, or change in form of a principal asset, including realized profit, subject to the subchapter" be allocated to principal.

Trust Construction

- In *In Re Vazquez*, a bankruptcy trustee appealed an order regarding the identity of beneficiaries of a trust.
- The bankruptcy trustee argued that several pieces of evidence established that there were multiple trust beneficiaries, including references to the term “beneficiaries” in the trust and in the later signed certificate of appointment.
- The court disagreed and noted that no beneficiary was named anywhere in the trust, and the repeated boilerplate references to term “beneficiaries” did not lead the court to conclude that the trust was intended to provide for multiple beneficiaries.

Trust Construction

- "This case is a poster child for the proposition that one should not rely on prepaid legal forms with boilerplate language for important legal matters. Had Debtor passed away, it is clear to the court that the document would not have accomplished what she hoped; indeed, all the tax consequences she hoped to avoid would have been visited upon her son. It is also clear that a properly drafted trust prepared by a competent lawyer would have accomplished the goal she sought in the first instance."

Trust Jurisdictional Issues

- In *Conestoga Settlement Trust*, a Texas trust filed suit in Texas against the RE Family Trust and its trustee, located in New York and New Jersey respectively, raising tortious interference claims with regard to benefits from a life insurance policy.
- Court denied special appearance and used normal personal jurisdiction analysis for same.

Trust Jurisdictional Issues

- In *Berry v. Chrysler Group, LLC*, plaintiffs, individuals residing in Texas, sued a car manufacturer and other related entities based upon an automobile accident in West Texas.
- The court *sua sponte* asked the parties to file briefs regarding the court's subject matter jurisdiction via diversity of citizenship.
- The court held that lower federal courts must consider the citizenship of beneficiaries of trusts as "members" of the trust, an artificial entity, in determining the diversity of citizenship analysis.

Trust Jurisdictional Issues

- In *Wildwood Capital Assets, LLC v. Westerfield*, the court held that the citizenship of a trust was solely that of its trustees.
- The court stated: "The citizenship of a trustee who possesses customary powers to hold, manage, and dispose of assets for the benefit of others is determined by the citizenship of the trustee, not the trust beneficiaries." *Id.*

Trust Jurisdictional Issues

- In *Curtis v. Brunsting*, the plaintiff was a beneficiary of a trust and sued co-trustees for breach of fiduciary duty in federal court.
- The trial court dismissed the case for lack of subject matter jurisdiction due to the probate exception.
- The court of appeals held that after *Marshall*, the probate exception only bars a federal district court from (1) probating or annulling a will or (2) seeking to reach a res in custody of a state court by endeavoring to dispose of such property.

Trust Jurisdictional Issues

- *Marshall* requires a two-step inquiry into (1) whether the property in dispute is estate property within the custody of the probate court, and (2) whether the plaintiffs' claims would require the federal court to assume in rem jurisdiction over the property.
- If the answer to both inquiries is yes, the probate exception precludes the federal district court from exercising diversity jurisdiction.
- Finding no evidence that the trust was subject to ongoing probate proceedings, the court concluded that the case fell outside the scope of the probate exception.

Claims By Trustees

- In *Rice v. Malouf*, a former co-trustee, acting alone without the knowledge of his co-trustee, caused \$1.6 million dollars to be transferred by wire from a trust bank account to the recipient's account.
- Other co-trustees later filed suit against the recipient for a constructive trust and sought the return of the money.

Claims By Trustees

- Section 284 of the Restatement of Trusts states that when a trustee in breach of trust transfers trust property to a person who takes it "for value" and "without knowledge of a breach of trust," the latter holds the interest free of the trust and is under no liability to the beneficiary.
- Issue in case was whether the transfer was "for value."

Claims By Trustees

- The court of appeals affirmed the jury's verdict that the transfer was "for value."
- The co-trustee who transferred the money had an entity that owed \$1.7 million to the recipient's businesses.
- The court held that the recipient of the funds was allowed to keep those funds.

Claims Against Trustees

- In *Derouen v. Bryan*, between 2002 and 2004, a beneficiary's wife contacted the trustee and sought distributions of funds to her husband.
- The trustee granted those requests and forwarded thousands of dollars in that time period via checks made out to the beneficiary and mailed to the beneficiary's address.
- The beneficiary sued the trustee for making improper distributions to a non-beneficiary, alleging breach of contract, breach of fiduciary duty, and negligence.

Claims Against Trustees

- The trustee filed a summary judgment motion claiming that the beneficiary's claims were barred by the statute of limitations as the beneficiary did not file suit until 2010.
- The court held that a cause of action generally accrues when a wrongful act causes some legal injury, regardless of whether the plaintiff knows of the injury or if all the resulting damages have yet to occur.
- The court held that for the discovery rule to apply, the nature of the injury must be inherently undiscoverable and the injury must be objectively verifiable.

Claims Against Trustee

- The discovery rule tolls limitations such that it does not begin to run until the plaintiff knew, or should have known with the exercise of reasonable diligence, of the facts giving rise to the cause of action.
- While the beneficiary claimed he did not acquire actual knowledge about the distributions until 2008, if he had exercised reasonable diligence in handling his personal affairs, he would have discovered the distributions sooner.

Claims Against Trustee

- Beneficiary also claimed that he requested the trustee to file suit against his wife to recover the funds in 2009 and that the trustee had refused to do so and thereby breached his fiduciary duty.
- The court held that the Texas Trust Code and the terms of the trust itself authorized the trustee, but did not require him, to pursue litigation against the wife.
- Absent bad faith or an abuse of discretion, which was not shown, the trustee could not be held liable for refusing to do so.

Claims Against Trustees

- In *United States v. Macintyre*, the government brought claims for personal liability against an executor and a trustee under the Federal Priority Statute, 31 U.S.C. Section 3713, for the defendants' distributions from a decedent's estate and trust to lower priority creditors.
- The trustee was personally liable for over \$1.1 million for trust funds that were permanently set aside in violation of the government's priority pursuant to Section 3713.

Claims Against Trustee

- In *Estate of Chaffin*, multiple parties settled disputes arising out of an estate.
- Section 149E(a) of the Texas Probate Code provides that "after an estate has been administered, and if there is no further need for an independent administration of the estate, the independent executor . . . may file an action for declaratory judgment," and the independent executor may seek his discharge as to any "matters relating to the past administration of the estate that have been fully and fairly disclosed."
- When such an action is filed, each beneficiary of the estate shall be personally served with citation, except for any who might have waived issuance and service of citation.

Fun Case

- In *Young v. Fawcett*, a grandmother filed suit for breach of fiduciary duty against her granddaughter and the granddaughter's husband.
- The grandmother had given her daughter \$40,000, all of the grandmother's assets, to build a house on the daughter's property.

Fun Case

- Daughter fell behind on her mortgage, and the granddaughter bought the entire property, including the grandmother's house, with assurances that the grandmother could remain living there.
- After seven years, the couple sold the property while the grandmother was away.
- They sent the grandmother a check for \$6,000, which was later dishonored.

Fun Case

- The court of appeals noted that the record contained evidence of objective manifestations of the grandmother's confidence and trust in her granddaughter and her husband such as the closeness of their longstanding relationship and the grandmother's support of the housing agreement.
- The court required the granddaughter and her husband to honor the granddaughter's promise to give the grandmother money for her house when they sold the property.

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.