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Trustee Quandary: Criminal Activity By A Beneficiary With Or On Trust Property

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Introduction

*Drug abuse and addiction are enormous issues in the United States and Texas.

*The Centers for Disease Control and Prevention reported last year that opioid overdoses are the leading cause of death for people younger than fifty.

*Unfortunately, it is not uncommon for a beneficiary of a trust to commit criminal activities on or with trust property.

*This places a trustee, who has knowledge of such conduct, in a difficult position with seemingly conflicting duties.

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Introduction

For example, a trust owns a vehicle and allows its primary beneficiary to use the vehicle for his personal needs, who then uses it to cook and distribute methamphetamine.

Should the trustee: 1) repossess the vehicle; 2) remediate and clean drug residue out of the vehicle; 3) sell the vehicle to a third party; 4) inform the police about the drug use and/or sale; 5) inform other secondary beneficiaries of the drug use issue; or 6) distribute additional funds to the beneficiary to allow the beneficiary to purchase a vehicle that the beneficiary will own?

Introduction

- What if the police arrest the beneficiary in the act of committing a crime, can the government seize the trust's vehicle? What if the beneficiary is involved in an accident with an innocent third person while he is intoxicated? Can the third person reach the trust's other assets to obtain compensation for his or her injuries?
- There are several important concerns that a trustee should consider in such situations: 1) the duty of loyalty the trustee owes the beneficiary and its limits, 2) the duty to properly manage trust assets, 3) the duty to report criminal activity, and 4) the duty to preserve evidence.

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Duty of Loyalty

- The first and most fundamental duty that a trustee owes its beneficiaries is the duty of loyalty.
- To determine a trustee's duty of loyalty, a trustee must first look to the trust document, statutory provisions, and the common law.
- Trust documents often limit the duty of loyalty by containing exculpatory clauses that eliminate liability for negligent actions.
- However, trust documents rarely discuss criminal activity and limit a trustee's duty of loyalty regarding a beneficiary's criminal activity.

Duty of Loyalty

- The Texas Property Code generally states that in "administering the trust the trustee shall perform all of the duties imposed on trustees by the common law." Tex. Prop. Code § 113.051.
- Otherwise, a trustee's duties focus on trust property: "The trustee is accountable to a beneficiary for the trust property and for any profit made by the trustee through or arising out of the administration of the trust..." Tex. Prop. Code § 114.001(a).

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Duty of Loyalty

- One must look to common law to determine the breadth of the duty of loyalty regarding a beneficiary’s criminal activity.
- A trustee is held to a high fiduciary standard.
- A trustee owes a beneficiary an unwavering duty of good faith, loyalty, and fidelity over the trust’s affairs and corpus.
- To uphold its duty of loyalty, a trustee must meet a sole interest standard and handle trust property solely for the benefit of the beneficiaries.

Duty of Loyalty

- The Texas Supreme Court has described the high duty of loyalty in the context of trust property: “A trust is not a legal entity; rather it is a ‘fiduciary relationship *with respect to property*.’ High fiduciary standards are imposed upon trustees, *who must handle trust property* solely for the beneficiaries’ benefit. A fiduciary ‘occupies a position of peculiar confidence towards another.’”
- Question: Does dealing with a beneficiary’s criminal activity involve a duty of loyalty to trust assets?

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Duty of Loyalty

- The Restatement in Section 166 provides: “The trustee is under a duty to the beneficiary not to comply with a term of the trust which he knows or should know is illegal, if such compliance would be a serious criminal offense or would be injurious to the interest of the beneficiary or would subject the interest of the beneficiary to an unreasonable risk of loss.”
- So, if a trust has a provision that is against the law or public policy, a trustee does not have to comply with it.
- The Restatement in Section 166 also provides: “The trustee is not under a duty to the beneficiary to do an act which is criminal or tortious.”
- A trustee does not violate a duty by complying with the law.

Duty of Confidentiality

- Generally, a trustee has a fiduciary duty to maintain the confidentiality of beneficiary's information.
- This is a subpart of the duty of loyalty.
- The duty of confidentiality becomes more complicated when the duty comes in conflict with a duty to disclose to other beneficiaries.

Duty of Confidentiality

- The Restatement provides: “This duty of confidentiality ordinarily does not apply to the disclosure of trust information to beneficiaries or their authorized representatives or, in the interest of one or more trust beneficiaries, to the trustees of other trusts or the fiduciaries of fiduciary estates in which a beneficiary has an interest.”
- However, “Even in providing information to or on behalf of beneficiaries, … the trustee has a duty to act with sensitivity and, insofar as practical, with due regard for considerations of relevancy and sound administration, and for the personal concerns and privacy of the trust beneficiaries.”
- So, a trustee may have a duty to disclose certain information to other beneficiaries.

Drafting Considerations

- A settlor may expressly allow a trustee to withhold distributions to a beneficiary or to terminate a beneficiary's interest where the beneficiary commits criminal activity.
- Such provisions may act as a deterrent and encourage a beneficiary to avoid criminal activities or else lose his or her rights to trust distributions and trust assets.
- Trustees, however, may want to be wary of these types of provisions: a trustee's ability to cut a beneficiary out or eliminate distributions is a fruitful area for litigation risk.

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Modifying Trusts To Eliminate Bad Beneficiaries

- A settlor may want to modify a trust to cut out a beneficiary who ends up being a bad actor.
- This can certainly be done with a revocable trust.
- Regarding an irrevocable trust, a trustee must seek judicial modification of the trust via Texas Property Code 112.054.
- The most applicable provision is Section 112.054(a)(2), wherein a court may modify a trust if circumstances not known to or anticipated by the settlor will further the purposes of the trust.
- But, under this provision, a trial court cannot modify a trust solely on its own discretion; rather, it must consider the settlor's intent.
- *Smith v. Hallam* case as an example.

Slayer Rule

- What if a remainder beneficiary kills the primary beneficiary?
- No statutory slayer rule in Texas for this scenario, but constitutional issues.
- In Texas, we have a common-law, equitable constructive trust claim.
- The trust operates to transfer the equitable title to the trust beneficiaries.
- Must prove intent by preponderance of evidence.

Duty to Manage Trust Assets

- A trustee has a duty to manage trust assets prudently, and meeting this duty may require a trustee to take certain actions to protect trust assets that are placed at risk when a beneficiary commits crimes.
- "A trustee's fundamental duties include the use of the skill and prudence which an ordinary, capable, and careful person will use in the conduct of his own affairs as well as loyalty to the trust's beneficiaries."
- It has a duty to properly manage, supervise, and safeguard trust assets.

Duty to Manage Trust Assets

- A trustee has a duty to prevent criminal activity on or with trust property because there is a risk that a state or federal governmental authority may seek a forfeiture of the property. Tex. Code Crim. Proc. § 59; 18 U.S. Code § 981.
- Civil forfeiture is a legal process in which law enforcement take assets suspected of involvement with crime or illegal activity without necessarily even charging the user of the property with wrongdoing.

Duty to Manage Trust Assets

- In *3607 Tampico Dr. v. State*, the government brought a forfeiture proceeding under Texas Code of Criminal Procedure Article 59.02(a) for a house owned by a trust. No. 11-13-00306-CV, 2015 Tex. App. LEXIS 13056 (Tex. App.—Eastland December 31, 2015, pet. denied).
- The house was held in a spendthrift trust for a son, and the mother was the trustee, and allowed the son to live in the house.
- The beneficiary operated a heroin operation out of the house and was charged and sentenced to federal prison for that crime.
- The trial court ordered a forfeiture of the home.
- The court of appeals rejected an argument that the state could not seize the property because the perpetrator did not own the property.
- The court also rejected the trustee's "innocent owner" defense because the trustee knew that the beneficiary had previously pleaded guilty to possession of nine pounds of marijuana a decade earlier.

Duty to Manage Trust Assets

- The trustee should also take care to avoid the risk of loss to other trust assets resulting from the improper use of trust assets by a beneficiary or other third person.
- In Texas, an owner of property or other person who has the right to control the property can potentially be liable for damages due to negligently entrusting the property to a third person who commits a tort with the property.
- A trustee may also be liable for negligent activity or premises defect claims.
- Claims are not limited to particular trust asset at issue.

Duty to Manage Trust Assets

- Prudent trustees should know of these risks and act accordingly.
- Trustee should eliminating any criminal activity on or with trust property by repossessing or evicting beneficiary from property.
- A trustee may simply distribute the asset to the beneficiary.
- The trustee may sell the property and use the proceeds for the beneficiary.
- The trustee can form holding companies.
- The trustee can obtain insurance.

Duty to Report Criminal Activity

- A trustee must also consider the legal duties it has to report criminal activity to governmental authorities. No trustee should have to go to jail protecting its beneficiary.
- Federal courts have held that there is a duty to report a crime, regardless of the type of crime.
- Misprision of a felony is a federal statute that holds that a person is criminally liable for the failure to report a felony crime and taking action to conceal the crime.

Duty to Report Criminal Activity

- As a general matter, there is no duty to report a crime in Texas, but there are exceptions.
- A person has a duty to report a crime where he has control over or a special relationship with the perpetrator.
- Also, there is a duty in Texas to report felonies—in contradiction to the general "no duty" rule. Texas has a statutory provision that bears a resemblance to the federal misprision of a felony statute.

Duty to Preserve Evidence

- A trustee who learns that the beneficiary has used trust property for criminal activity may want to eventually clean the property.
- For example, methamphetamine is a crystal that vaporizes when heated, adheres to surfaces, and reforms into crystals.
- People who contact these surfaces can ingest the meth crystals through their skin.
- A trustee may reasonably want to clean up this contamination as soon as possible to protect its employees, the beneficiary, and other parties.
- But this desire to clean up contaminated property may conflict with a duty to preserve evidence.

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Duty to Preserve Evidence

- Under 18 U.S.C. Section 1519, it is a federal crime to knowingly destroy evidence if there is a reasonable anticipation of litigation.
- Similarly, in Texas, a party can be guilty of destroying or concealing evidence of a crime.
- Specifically, the Texas Penal Code provides: “A person commits an offense if the person: (1) knowing that an offense has been committed, alters, destroys, or conceals any record, document, or thing with intent to impair its verity, legibility, or availability as evidence in any subsequent investigation of or official proceeding related to the offense.” Tex. Pen. Code § 37.09(d).
- This offense only requires that the defendant know that an offense has been committed.

Duty to Preserve Evidence

- A trustee should be very careful to not destroy or conceal evidence of a beneficiary's criminal conduct, as doing so may expose the trustee to potential federal or state criminal charges.
- A trustee may want to consult with an attorney and obtain legal advice in this situation.
- If a trustee reports criminal activities or preserves evidence for authorities under the advice of counsel, this advice of counsel may be a defense in any suit by a beneficiary.

Conclusion

- Trustees find themselves in very difficult positions when their beneficiaries engage in criminal activities with or on trust property.
- Trustees know that they have a duty of loyalty to their beneficiaries, but this duty is not all encompassing.
- Rather, there is a duty to report a felony crime under both federal and Texas law.
- Regarding the duty to preserve evidence, both federal and state courts are liberal in the application of their respective laws criminalizing a party who destroys or hides evidence.
- When a trustee faces this situation, it should retain an attorney to provide advice.