

Trust Litigation In Texas

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Introduction

Trustees have a difficult job in managing assets for the benefit of the beneficiaries.

Trustees have high fiduciary duties of loyalty, prudence, impartiality, and disclosure.

This creates unique challenges for trust administration that can lead to litigation.

This presentation will address the basics of trust litigation in Texas.

Areas To Discuss



What is a trust?

Trustee fiduciary duties

Standing to bring claims

Parties to trust disputes

Capacity issues

Interim relief and paying attorneys

Discovery issues

Trial issues

Remedies

Criminal Statutes

What is a Trust?



A trust is a legal relationship in which the owner of property gives it to another person or entity who must keep and use it solely for another's benefit.



In Texas, a trust is not a separate entity.

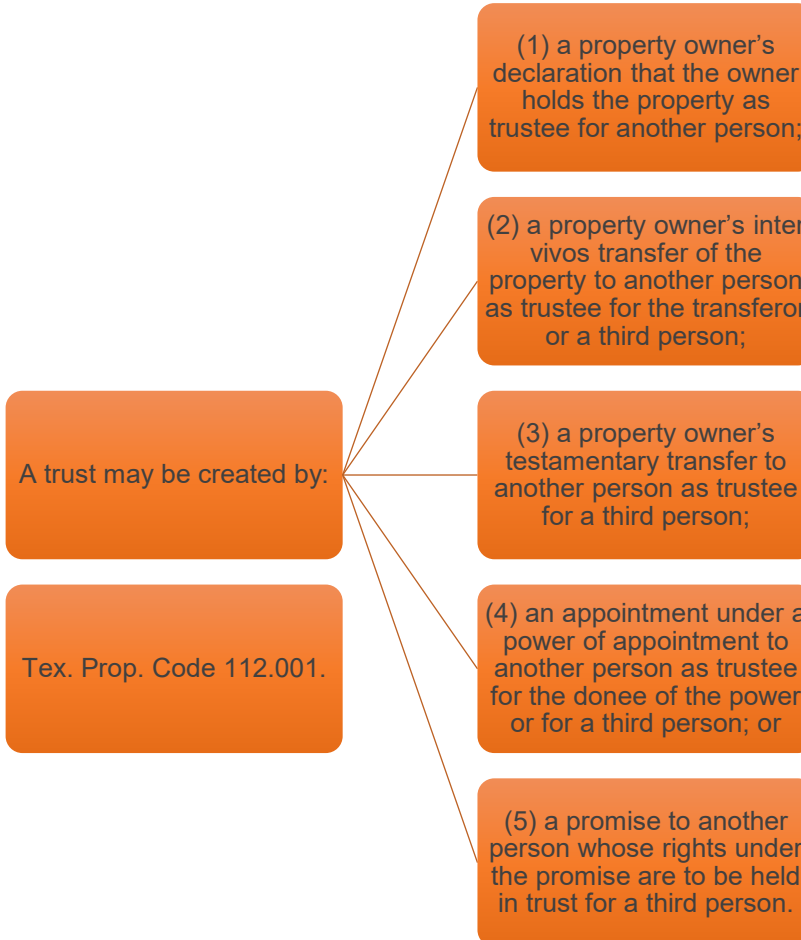


In English common law, the party who entrusts the property is known as the "settlor," the party to whom the property is entrusted is known as the "trustee," the party for whose benefit the property is entrusted is known as the "beneficiary," and the entrusted property itself is known as the "corpus" or "trust property."

What is a Trust?

- The trust system developed the following fundamental principles:
 - Separation of legal and beneficial ownership — the trustee holds legal title while beneficiaries hold equitable interest
 - Fiduciary duties — trustees must act in the best interest of beneficiaries
 - Flexibility — trusts could be adapted for various purposes including property management, family succession planning, and charitable giving

What is a Trust?



What is a Trust?

No particular form of words is required to create a trust; however, to create a trust a document must be reasonably certain as to the putative trust's property, its object, and the beneficiary.

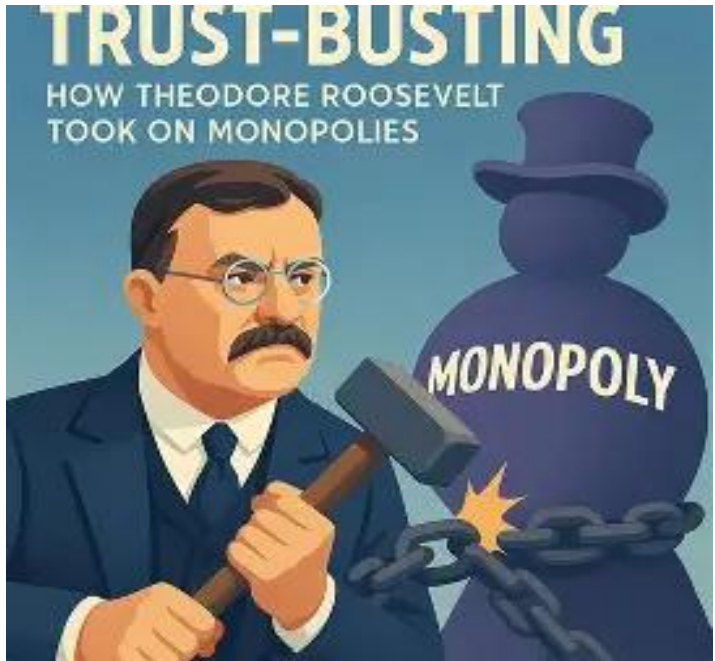
A court looks to the settlor's intent to determine whether a trust was created. See Tex. Prop. Code Ann. § 112.002 ("A trust is created only if the settlor manifests an intention to create a trust.").

“Property’ means any type of property, whether real, tangible or intangible, legal, or equitable, including property held in any digital or electronic medium. The term also includes choses in action, claims, and contract rights, including a contractual right to receive death benefits as designated beneficiary under a policy of insurance, contract, employees’ trust, retirement account, or other arrangement.” Tex. Prop. Code § 111.004(12).

Fiduciary Duties

- A trustee is held to the highest fiduciary standards:
 - Loyalty
 - Administer trust in good faith
 - Administer trust in accordance with terms and purposes of trust
 - Administer trust solely in interest of beneficiaries
 - Impartiality
 - Prudent administration
 - Use special skills or expertise
 - Exercise reasonable care, skill and caution
 - Make trust property productive
 - Keep books and records
 - Inform beneficiaries of material facts
 - See Uniform Trust Code §§ 801–13 (2000).

Trust Busting!



The existence of a trust can be challenged.

A trust created for a fraudulent purpose will not be enforced. *Rogers v. Rogers*, 240 S.W. 1104, 1105 (Tex. Comm'n App. 1922, judgment adopted).

For example, in *Dudley v. Lawler*, a court reversed a summary judgment for a defendant/husband regarding the funding of a family trust and held that the husband's representations as to nature and extent of community estate, if false, should be treated as fraud, justifying claims to void the transfer of property to the trust. 468 S.W.2d 160, 163 (Tex. Civ. App.—Waco 1971, no writ).

Trust Busting!

- Like wills, deeds, bank account agreements, and other legal documents, a trust can be challenged for mental incompetence.
- A trustor must have the competence to execute a contract to execute a trust: a person must have the mental capacity to: appreciate the effect of what they are doing; understand the nature and consequences of their acts; and understand the business being transacted
- This is a different standard than from a will contest, which is defined as possessing sufficient mental ability at the time of the will's execution to: understand the business in which the testator is engaged (i.e., making a will); understand the effect of making the will; understand the general nature and extent of the testator's property; know the natural objects of the testator's bounty (e.g., family members or other beneficiaries); and have sufficient memory to assimilate the elements of the business to be transacted, hold those elements long enough to perceive their relation to each other, and form a reasonable judgment about them.

Trust Busting!

- A trust can also be challenged on the basis of undue influence.
- Undue influence occurs when the free agency of the settlor (or testator) is destroyed, resulting in a document that reflects the will of the influencer rather than the true intentions of the settlor. *Rothermel v. Duncan*, 369 S.W.2d 917 (1963).
- To establish undue influence, the party contesting the trust must prove three elements by a preponderance of the evidence:
 - **The Existence and Exertion of an Influence:** There must be evidence that an influence was present and actively exerted over the settlor. This influence must go beyond mere requests or entreaties, as such actions are insufficient unless they are so excessive as to subvert the settlor's free will.
 - **The Effective Operation of Such Influence:** The influence must have operated to subvert or overpower the mind of the settlor at the time of the execution of the trust document. This requires evidence that the settlor's mental or physical state made them susceptible to such influence, and that the influence was actually exerted to such a degree that it overpowered their free agency .
 - **The Execution of a Document the Settlor Would Not Have Executed But For Such Influence:** The contestant must demonstrate that the trust document would not have been executed in the absence of the undue influence. This requires showing that the terms of the trust reflect the will of the influencer rather than the true intentions of the settlor.

Trust Busting!

Texas Trust Code 112.054 allows a court to terminate a trust on certain grounds.

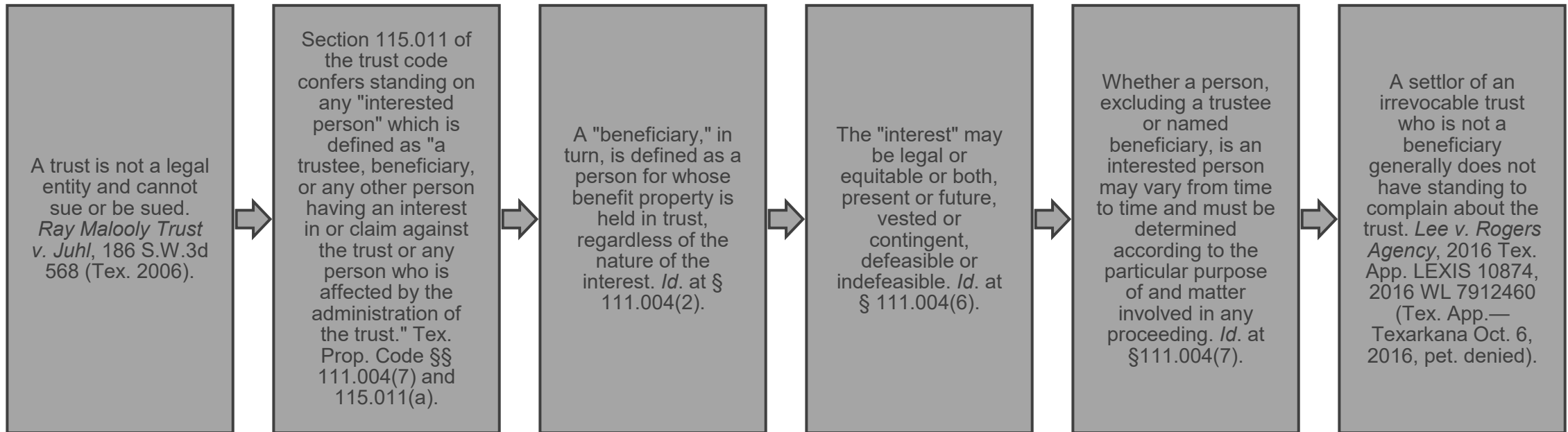
A court may order that a trust be terminated in whole or in part, if:

(1) the purposes of the trust have been fulfilled or have become illegal or impossible to fulfill;

(2) because of circumstances not known to or anticipated by the settlor, the order will further the purposes of the trust;

(3) subject to all beneficiaries agreeing, findings that (A) continuance of the trust is not necessary to achieve any material purpose of the trust; or (B) the order is not inconsistent with a material purpose of the trust.

Trust Disputes: Standing



Trust Disputes: Standing

A trustee may sue third parties for various causes of action.

A trustee may sue a beneficiary for declaratory relief and other relief.

A co-trustee may sue another co-trustee for violations of duty.

A beneficiary may sue a trustee for violations of a duty.

BUT a minority co-trustee may not sue on behalf of the trust.

Trust Disputes: Standing

- Texas courts have historically held that a trust beneficiary may enforce a cause of action that the trustee has against a third party “if the trustee cannot or will not do so.”
- Where a beneficiary is allowed to sue on behalf of the trust, any recovery would still go to the trust and not the beneficiary in his or her individual capacity. *See Fetter v. Brown*, No. 10-13-00392-CV, 2014 Tex. App. LEXIS 11209 (Tex. App.—Waco October 9, 2014, pet. denied).
- Beneficiaries can potentially stop a trustee from filing suit: Texas Trust Code section 113.028 provides that a trustee may not assert a claim against a party that is not a beneficiary if the beneficiaries provide written notice to the trustee of their opposition to the trustee’s asserting a claim. Tex. Prop. Code Ann. § 113.028(a).

Attorney-Client Communications

Confidential communications between client and counsel made to facilitate legal services are generally insulated from disclosure. See Tex. R. Evid. 503(b); *In XL re XL Specialty Ins. Co.*, 373 S.W.3d 46, 49 (Tex. 2012) (orig. proceeding).

Texas allows a trustee to maintain attorney-client privilege as against the trust's beneficiaries. See *Huie v. DeShazo*, 922 S.W.2d 920, 923 (Tex. 1996).

No fiduciary exception to attorney client communications as in other jurisdictions.

Unclear as to whether successor trustees own the privilege of former trustees.

Jurisdiction For Trust Disputes

The Texas Property Code describes the following jurisdiction of district courts regarding trust disputes: “[A] district court has original and exclusive jurisdiction over all proceedings by or against a trustee and all proceedings concerning trusts...” Tex. Prop. Code 115.001(a).

Statutory probate courts have concurrent jurisdiction over actions involving an inter vivos trust or testamentary trust. Tex. Estates Code § 32.006.

A statutory probate court has exclusive jurisdiction over probate proceedings, whether contested or uncontested. Tex. Estates Code § 32.005.

A county court at law in Texas may have jurisdiction over trust disputes when such jurisdiction is explicitly conferred by statute, particularly in counties with specific statutory provisions granting concurrent jurisdiction with district courts or in probate-related matters as defined by the Estates Code.

Venue For Trust Disputes



The Texas Property Code provides for venue for trust disputes arising under the Property Code. Tex. Prop. Code 115.002.



Generally, venue resides in the county where the trust has been administered for the past four years.



Statutory provisions for transferring venue and also for the parties to agree to venue.



This venue statute is mandatory, and a trial court's refusal to comply with it may result in a successful mandamus proceeding. *In re Green*, 527 S.W.3d 277 (Tex. App.—El Paso 2016, original proceeding).

Parties For Suit

- The Texas Property Code provides that only necessary parties to such an action are:
 - (1) a beneficiary of the trust on whose act or obligation the action is predicated;
 - (2) a beneficiary of the trust designated by name, other than a beneficiary whose interest has been distributed, extinguished, terminated, or paid;
 - (3) a person who is actually receiving distributions from the trust estate at the time the action is filed; and
 - (4) the trustee, if a trustee is serving at the time the action is filed.
- Tex. Prop. Code § 115.011(b).

Parties for Suit

However, the failure to join necessary parties under this statutes does not necessarily mean that the court lacks jurisdiction to settle trust disputes before it.

Rule 39 governs whether parties must be joined before a court may proceed with adjudication. See Tex. R. Civ. P. 39.

If the trial court determines that it is not feasible to join a party who should otherwise be joined, the court must proceed with an analysis under subsection (b) to determine “whether in equity and good conscience the action should proceed among the parties before it.” Tex. R. Civ. P. 39(b).

The Texas Supreme Court has stated, “Under the provisions of our present Rule 39 it would be rare indeed if there were a person whose presence was so indispensable in the sense that his absence deprives the court of jurisdiction to adjudicate between the parties already joined.”

Attorney General As A Party

- A party must provide notice to the Attorney General of certain suits:
 - “Any party initiating a proceeding involving a charitable trust shall give notice of the proceeding to the attorney general by sending to the attorney general, by registered or certified mail, a true copy of the petition or other instrument initiating the proceeding involving a charitable trust within 30 days of the filing of such petition or other instrument, but no less than 25 days prior to a hearing in such a proceeding.” Tex. Prop. Code § 123.003
- Failure to serve state attorney general in an appropriate case will render the judgment void and unenforceable.

Capacity Matters



Parties can wear multiple hats: trustee, beneficiary, officer, director, agent for a third party, etc.

A plaintiff must be careful to sue the defendant in the correct capacities.

Must serve them in the correct capacities.

Otherwise, a judgment against a trustee in that capacity will not mean that the trustee, individually, will be responsible for paying a judgment.

Parties Paying Counsel

- Beneficiaries often attempt to have the trust pay their attorney's fees, but this can only be done as a distribution to the beneficiary, if allowed by the trust document.
- Trustees who are sued for breach of duty typically pay for defense out of the trust.
- However, the Trust Code (114.064) states that a court may award fees upon a showing of equitable, just, necessary and reasonable.
- Texas Estate Code precedent holds that executors cannot pay for defense in a removal action before a finding of good faith at the end of the litigation.
- Courts have held that paying for a trustee's counsel from a trust can be a breach of duty if the trustee ultimately loses on the underlying claim.
- So, trustees should proceed with caution, and beneficiaries may file motions to stop the payment of attorneys from trust assets.

Interim Remedies

- Under the Texas Trust Code § 114.008, a court has broad discretion to award various forms of interim relief or remedies to address breaches of trust or potential breaches; the court may:
 - (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 or the proceeds from the property; or
 - (10) order any other appropriate relief.

Discovery/Evidence Issues

The Dead Man's Rule is very important in trust and estate litigation.

The Dead Man's Rule governs the competency of witnesses in certain civil cases involving oral statements made by deceased individuals. Tex. R. Evid. 601.

The rule is designed to ensure fairness by preventing testimony from a living party about oral statements made by a deceased person, whose death precludes rebuttal.

Exceptions: The rule allows testimony about the decedent's oral statement if: the testimony is corroborated by other evidence, or the opposing party calls the witness to testify about the statement at trial.

Some courts have held that even asking about the decedent's statements in discovery (interrogatories and deposition) can waive the application of the Dead Man's Rule.



Trial Issues: Burden of Proof

- Generally, the plaintiff has the burden of proof to prove that the defendant breached his or her fiduciary duties and the damages for same.
- However, if the claim involves a self-interested transaction, then the burden of proof shifts to the defendant to prove the following elements:
 - Good Faith: The trustee must demonstrate that the transaction was conducted in good faith. This requires showing that the trustee acted with honesty, integrity, and without any intent to deceive or harm the beneficiary.
 - Fair Consideration: The trustee must prove that the transaction was for fair and adequate consideration. This means that the value exchanged in the transaction was reasonable and equitable under the circumstances.
 - Full and Complete Disclosure: The trustee must show that all material information regarding the transaction was fully and completely disclosed to the beneficiary. This includes providing the beneficiary with sufficient information to understand the nature, risks, and consequences of the transaction.
 - Fairness and Equity: The trustee must establish that the transaction was fair, honest, and equitable to the beneficiary. This involves demonstrating that the trustee did not use their position to gain an advantage at the expense of the beneficiary and that the transaction did not result in significant benefit to the trustee at the beneficiary's detriment.
 - Independent Advice and Consent: While not always explicitly required, courts may consider whether the beneficiary had the benefit of independent advice or legal counsel in evaluating the fairness of the transaction.
- The burden to prove the other elements (that the defendant owed fiduciary duties and damages or benefit to the fiduciary) are still on the plaintiff.

Trial Issues: Burden of Proof



The burden of proof issue is very important.



Motion to open and close if the defendant has the burden on the claim.



Charge questions (jury instructions) should be worded to properly place the burden of proof.



The *White vs. White* case is a trust case that was reversed due to improper burdens of proof in the jury instructions.

Remedies In Trust Litigation

Modification/reformation/termination relief

Actual damages (direct, consequential, incidental, mental anguish)

Attorney's fees

Compensation forfeiture

Profit/consideration disgorgement

Punitive Damages

Declaratory Relief

Equitable Remedies (constructive trust, liens, permanent injunction, rescission, etc.)

Criminal Issues

- **Fiduciary Misapplication of Property:** a trustee, as a fiduciary, commits an offense if they intentionally, knowingly, or recklessly misapply property held in a fiduciary capacity in a manner that involves a substantial risk of loss to the owner or beneficiary of the property. Tex. Penal Code § 32.45.
- **Theft:** theft is defined as the unlawful appropriation of property with the intent to deprive the owner of the property. Tex. Penal Code § 31.03.
- **Duty to Report.** There is a duty to report elder abuse under Texas Human Resources Code and other laws.
- **Elder Abuse.** There are multiple elder abuse criminal statutes: Financial Abuse or Exploitation of an Elderly Individual (Tex. Penal Code § 32.55); Exploitation of Child, Elderly Individual, or Disabled Individual (Tex. Penal Code § 32.53).

Conclusion



Summary: It is a marathon, not a sprint; patience and documentation are the trustee's best tools.

Final Thought: The goal is to maximize value for the trust while maintaining the integrity of the business entity.

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