AVOIDING FIDUCIARY LITIGATION

Panel:

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Friday, February 8, 2013, 8:30 a.m.
.75 hours ethics

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The focus of the members of this panel is what advice can we, as lawyers, offer to our clients who accept fiduciary appointments that will help avoid or at least minimize conflicts that can lead to litigation or, if in litigation, can end that conflict and minimize the damage. Our focus is on behavior, transparency, and communication, not on what language can be included in drafting that will allow a trial attorney to argue more forcefully for a position that favors his or her client.

Résumés of panelists are attached at the end. A short summary is as follows: (1) Kathleen Ford Bay, rather traditional trusts & estates attorney, since 1979, which included planning to avoid and control conflict and settle disputes; (2) Jim J. Hartnett, Jr., trial attorney with depth of experience in trusts and estates matters, representing both beneficiaries and fiduciaries, since 1983; (3) The Honorable Polly Jackson Spencer, Probate Court Number One, Bexar County, appointed July 1990, then re-elected since then; and Dean M. Kilgore, attorney-mediator-arbitrator, in excess of 1,300 mediations and arbitrations.

The following is in great part (mostly) based on Jim Hartnett's November 2012 presentation to the Dallas Estate Planning Council entitled "Fiduciary Litigation – Some Attitudes or Acts that Might get You in It, and Some Steps to Help Get You Out" (hereafter, "Hartnett").

Fiduciary. A fiduciary is a person, individual or corporate, in whom, in which trust and confidence are placed *as a matter of law* and also contract, such as trustee-beneficiary, executor-beneficiary, principal-agent: a formal fiduciary relationship. A fiduciary may also have an information relationship which rises to trust and confidence and so the person becomes a fiduciary in that manner.

Because a fiduciary owes duties to others, a fiduciary is also a TARGET.

The legal burden is upon the fiduciary to prove that he, she, or it followed the fiduciary duties of loyalty, good faith, disclosure, prudent management, impartiality.

Balancing the Role of a Fiduciary: Different Hats. An individual fiduciary may also be a beneficiary (less commonly, but also possible, is a charity that is fiduciary and one of the beneficiaries). If so, the fiduciary is wearing different hats and the fiduciary hat must always, must always be worn in preference to the beneficiary hat. Advise your fiduciary client to be professional in carrying out duties.

Advise your fiduciary client not to retaliate against another beneficiary for perceived bad behavior, and to treat all the beneficiaries in the same non-judgmental, judicious manner. If your client cannot keep the professional hat on and overlook personal feelings of ill-will (even though others might agree that such feelings are justified), then you may want to advise your client to resign or not accept the appointment. Another way of putting this (from the perspective of the unhappy beneficiary) is, “Do not be witchy with respect to any beneficiary, ever.”

Your Fiduciary client Must be on the Alert and Address Concerns of Each Beneficiary:

Tell the Fiduciary, **“Don’t Stick Your Head in the Sand”**.

"One of the easiest ways to get in trouble is to ignore the facts and circumstances involving your beneficiaries or to ignore problems when they arise. 'I didn't know,' 'he never asked,' or 'it's not my business' are rarely good excuses for a fiduciary when it comes to matters within the scope of the relationship." (Direct Quote from Hartnett.)

"If I Ignore Him Maybe He'll Leave Me Alone."
Really? Doesn't lack of communication raise suspicions that the fiduciary is misbehaving? Isn't a beneficiary more likely to seek counsel of an attorney when suspicious?

"Maybe I can make things difficult and he'll back off."
Fiduciary refuses to deal directly with the beneficiary; refuses to answer the phone or provide cell phone, email address, etc. Directs beneficiary to direct all correspondence through an attorney, but then the attorney will not do anything but take messages and send them on as the attorney does not represent the beneficiary, only the fiduciary. Beneficiary senses that assets are being used to pay the attorney.

Fiduciary Must Disclose and Report.
"One of the primary duties of a fiduciary is to keep full, accurate and orderly records concerning the status of the relationship and all acts performed thereunder. For example, a trustee is charged with the duty of maintaining an accurate account of all of the transactions relating to the trust property. He is chargeable with all assets coming into his hands, the disposition for which he cannot account. *Corpus Christi Bank & Trust v. Roberts*, 587 S.W.2d 173 (Tex. Civ. App. - Corpus Christi 1979, affirmed at 597 S.W.2d 752 (Tex. 1980)). Beneficiaries may ask for a statutory accounting and the Trust Code details what must be provided. This is not the time to be hiding information and hoping the beneficiary goes away." Hartnett.

"I don't have to tell you" and privilege issues, attorney-client and attorney-work product.
Punts v. Wilson, 137 S.W.3d 889 (Tex. App.-Texarkana 2004). In the context of the executor also being a POD (payable on death) beneficiary and the other beneficiary under the will claiming that the executor was required as a fiduciary to provide full disclosure about the non-probate assets and, in fact, include them in the probate estate and inventory, and a summary judgment by the trial court in favor of the executor, the Appellate Court discussed a fiduciary's duties:

> The fiduciary duties owed to the beneficiaries of an estate by an independent executor include a duty of full disclosure of all material facts known to the executor that might affect the beneficiaries' rights. *Montgomery v. Kennedy,* 669 S.W.2d 309, 313 (Tex.1984) (trustees of trust and executors of estate had fiduciary duty of full disclosure to beneficiary); *see Huie[v. DeShazo],* 922 S.W.2d at 923 [Tex. 1996]. A fiduciary also "owes its principal a high duty of good faith, fair dealing, honest performance, and strict accountability." *Ludlow v. DeBerry,* 959 S.W.2d 265, 279 (Tex. App.-Houston [14th Dist.] 1997, no writ). When an independent executor takes the oath and qualifies in that capacity, he or she assumes all duties of a fiduciary as a matter of law which, in addition to other duties, includes the duty to avoid commingling of funds. *Humane Soc'y,* 531

> S.W.2d at 577; *Geeslin v. McElhenney,* 788 S.W.2d 683, 686-87 (Tex. App.-Austin 1990, no writ)." *Punts* at 891 and 892.

The Appellate Court looked at the decedent's intent and held that the executor did *not* owe fiduciary duties regarding the POD accounts to the other beneficiary under the will. If that beneficiary wished to take the position that fiduciary duties were owed, he had the burden of proving it; the Appellate Court upheld the summary judgment in favor of the executor.

May a fiduciary assert an attorney-client privilege as a bar to disclosing the information that the fiduciary would otherwise be required to disclose? Probably not. *See Huie v. DeShazo*, 922 S.W.2d 920 (Tex. 1996) regarding a fiduciary's privilege. However, when the beneficiary had indicated that he or she or it (if a charity) may seek counsel to challenge the fiduciary, those attorney-client, attorney-work discussions probably are privileged; it's just the day-to-day activities that are not. This does not mean that the beneficiary can force the attorney to reveal communications with the fiduciary.

> The trustee's duty of full disclosure extends to all material facts affecting the beneficiaries' rights. Applying the attorney-client privilege does not limit this duty. In Texas, the attorney-client privilege protects confidential communications between a client and attorney made for the purpose of facilitating the rendition of professional legal services to the client. See TEX.R.CIV.EVID. 503(b). While the privilege extends to the entire communication, including facts contained therein, see *GAF Corp. v. Caldwell,* 839 S.W.2d 149, 151 (Tex. App.--Houston [14th Dist.] 1992, orig. proceeding); 1 STEVEN GOODE ET. AL, TEXAS PRACTICE: GUIDE TO THE TEXAS RULES OF EVIDENCE: CIVIL AND CRIMINAL, § 503.5 n. 15 (1993), a person cannot cloak a material fact with the privilege merely by communicating it to an attorney. See, e.g., *National Tank Co. v. Brotherton,* 851 S.W.2d 193, 199 (Tex.1993).
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> This distinction may be illustrated by the following hypothetical example: Assume that a trustee who has misappropriated money from a trust confidentially reveals this fact to his or her attorney for the purpose of obtaining legal advice. The trustee, when asked at trial whether he or she misappropriated money, cannot claim the attorney-client privilege. The act of misappropriation is a material fact of which the trustee has knowledge independently of the communication. The trustee must therefore disclose the fact (assuming no other privilege applies), even though the trustee confidentially conveyed the fact to the attorney. However, because the attorney's only knowledge of the misappropriation is through the confidential communication, the attorney cannot be called on to reveal this information. *Huie* at 923.

"You'll Get It When I Am Ready."

Really? Isn't it more politic and acceptable for a fiduciary to provide the information in the raw and then say I am putting it into a more formal format and will give that to you as soon as it's ready? Also, hire an accountant and let the time taken be the responsibility of the accountant, not the fiduciary.

"I Know What's Best and What Your Mom Intended;" "I'm trying to protect you from yourself;" "I'll give you your money when you start acting like a better person."

Remember, the fiduciary needs to maintain a professional attitude and be impartial and not apply his, her, or its own interpretation and judgment. The terms of the fiduciary's duties and discretions are partly contained in the law (Trust Code, Probate Code, Power of Attorney Act) and partly in the actual written document.

Don't add requirements and restrictions.

The fiduciary is to follow what is in the written document.

Not exercising "discretion.
"Doing nothing is not a proper exercise of discretion and there is no such thing as 'absolute discretion.' Get some back-up for your decision and document it." Hartnett.

A fiduciary should not borrow from the property under the fiduciary's control, even though doing so seems easy and makes sense: "I Promise I'll Pay It Back;" "It's a good interest rate too;" "A fiduciary pays the highest rate allowed by law."

A fiduciary must follow the prudent person rule of investing, unless specifically directed otherwise in the written document. Do not use assets under the fiduciary's control except for legally acceptable investments: "Boy, Have I Got a Deal for You;" "My buddy has a great investment;" "I just got back from a seminar – I can make you rich."

A fiduciary may ask for a receipt, but may not insist on a release before releasing property, unless the fiduciary is in the process of doing a formal accounting: "I'll Do It, But Sign This Release, I Mean Receipt, First."

Probate §151(d) says you can get a receipt, but not a release. A beneficiary's waiver or release does not count unless it is fair and based on full disclosure.

A fiduciary administers the assets for the benefit of the beneficiaries (and the fiduciary may also be wearing that fiduciary hat), not for himself. *Trostle v. Trostle,* 77 S.W.3d 908 (Tex. App.-Amarillo 2002).

"Let's Be Friends."

Is being a friend with the beneficiaries instead of maintaining a professional relationship more or less likely to result in unhappiness on the part of a beneficiary? "**Those improper emails won't come back to haunt me;" "It's more fun if we can make our relationship more relaxed."**

How does it look if the fiduciary is pals with one beneficiary, but not the others?

"We are NOT friends. I've got the control, so I am really the master, not you, the beneficiary." "It's about me, not you."

A Fiduciary's duty is to administer the estate/trust for the benefit of the beneficiaries. *Trostle v. Trostle,* 77 S.W.3d 908 (Tex. App.- Amarillo 2002).

"Oops, That Might Hurt." (All of this is from Hartnett.)

Fee Forfeiture.

Presumptions.

When a fiduciary profits or benefits in any way from a transaction with the beneficiary, a presumption of unfairness arises and shifts the burden of persuasion to the fiduciary.

Jury Charge.

The fiduciary must show:

i.) The transaction was fair and equitable to Paul Payne [Read that as "Pain.")

ii.) The fiduciary made reasonable use of the confidence that Paul Payne placed in him.

iii.)The fiduciary acted in the utmost good faith and exercised the most scrupulous honesty toward Paul Payne.

iv.)The fiduciary placed the interests of Paul Payne before his own, did not use the advantage of his position to gain any benefit for himself at the expense of Paul Payne, and did not place himself in any position where his self-interest might conflict with his obligations as a fiduciary?

v.) The fiduciary fully and fairly disclosed all important information to Paul Payne concerning the transaction.

Damages – The Horror Stories.

Damage Control

Cut and run or stand and fight?

1. The fiduciary resigns
2. The fiduciary hangs on
3. Do you fight to protect the trust?

The first tough decision is whether to dig in or cut and run. In our experience, more often than not, the beneficiary wants a new fiduciary more than anything else. Even though there may be obvious damages, these suits are costly and time-consuming, often involving expensive accounting work and expert testimony. Even if your fiduciary has caused damage to the beneficiary or the trust, there is a good chance that he or she can escape liability simply by resigning from the fiduciary position.

One of the first questions counsel should ask (especially if it means no financial consequences or a low amount of damages) is whether the client is willing to resign in return for a release. If so, then very early in the process, counsel should raise this option with the beneficiary's counsel. Resignation has resolved many fiduciary lawsuits before they got out of hand. Even if this tactic does not work early in the case, it may work later on as the beneficiary grows tired of the fight or the expense. Some of these cases become so expensive and/or time consuming that the beneficiary is relieved to just walk away with a new fiduciary.

One obstacle is that some fiduciaries believe that the position is all about them – he is the boss; she is the anointed one; "the testator picked me"; "this is what my dad wanted"; "I owe it to him"; etc. ***These fiduciaries are begging for trouble***. [Emphasis added.] We [Hartnett firm attorneys] have seen millions of dollars awarded by juries against stubborn defendants who persuaded themselves not to settle, due to the conviction that they were doing what the settlor/testator wanted. And what does a lawsuit victory really get the fiduciary anyway? The concept of *res judicata* offers limited relief when there are ongoing fiduciary duties. *See e.g., Uzell v. Roe,* 2009 WL 1981389 (Tex. App.-Austin, no pet.). Even if the fiduciary wins, a new cause of action arguably accrues the next day, and a jury may not see things so favorably for the fiduciary the next go-round. Each fiduciary decision creates a new opportunity for a beneficiary to sue the fiduciary. Each time the beneficiary sues, the suit probably gets easier (or at least cheaper), especially when the goal is removal.

To be sure, there are situations where the beneficiary's claims are so repetitive and frivolous that subsequent suits become easier for the fiduciary. But who really wants to be in that position? If there is an option to resign in exchange for the release of potential financial liability, that is usually a wise trade.

In some situations, especially trust litigation, the beneficiary may also be satisfied if the trust is terminated. This may be harder to accomplish if there are contingent or residuary beneficiaries. The fiduciary and the lawyer are sometimes faced with a dilemma: save the fiduciary and let the beneficiary loot the trust, or protect the beneficiary from himself and honor the testator's or settlor's wishes? To this writer [Hartnett], it is an easy call. If the fiduciary is sued for damages, he is being attacked personally, and every legitimate legal step should be taken to protect him. If trust termination is an option, it should be considered regardless of what the settlor or testator wanted. It is doubtful that the settlor or testator wanted the fiduciary to be sued or the corpus to be wasted in litigation either. Often, this notion of fulfilling the testator's wishes, or wanting to prevent the beneficiary (or his lawyer) from getting a windfall, will lead counsel to fight to uphold "the intent." While that is a noble fight, it may come at the sacrifice of your client. [Comment: If you take the request to terminate to a Court, the Judge will then be the voice interpreting the document and applying the law and the resolution is then out of the fiduciary's hands – and this will relieve tension.]

Litigation Appears to be More Likely Now Than in the Past. What Should you Discuss with Your Client – either the Beneficiary or the Fiduciary?

Disclose. Disclose, Disclose. [All the following is from Hartnett.]

Because the fiduciary typically has a duty of full disclosure of all material facts, it is important that he or she make that full disclosure even if it means divulging obvious breaches of fiduciary duty. To most fiduciaries who have messed up, this is unthinkable. They instead look for a way to compound their breach by covering it up or finding a way to keep it hidden.

It is likely that all bad information will come to light in a lawsuit anyway. For the fiduciary it is also extremely difficult, if not impossible, to obtain a release of liability from wrongs that have not been disclosed. That is why he has the duty to disclose. The duty of full disclosure is an **"affirmative duty to make a full and accurate confession of all his fiduciary activities, transactions, profits, and mistakes.**" *Jackson Law Office, P.C. v. Chappell,* 37 S.W.3d 15, 22 (Tex. App.-Tyler 2000, pet. denied) (citing *Montgomery v. Kennedy,* 669 S.W.2d 309, 312-14 (Tex. 1984). The breach of the duty of full disclosure by a fiduciary is tantamount to fraudulent concealment. *Chappell,* 37 S.W.3d at 22 (citing *Willis v. Maverick,* 760 S.W.2d 642, 645 (Tex. 1988).

In making voluntary disclosure (or responding to discovery), the fiduciary must decide whether to assert the attorney-client privilege. While there is no question that the privilege for communications during the litigation must be preserved, the privilege for pre-litigation communication is a different matter. One should consider waiving the attorney-client privilege for communications that occurred pre-litigation, even though *Huie v. DeShazo*, 922 S.W.2d 920 (Tex. 1996), makes clear that the privilege applies to these communications. Protecting the privilege "just because" gives the fiduciary no benefit and probably is a detriment. Everyone assumes that when information is withheld it is damaging; this is especially true for the already-suspicious beneficiary. Our experience has been that usually there is very little, if anything, that will be damaging if revealed, whereas asserting a privilege fuels the beneficiary's suspicions and often expands the litigation. In the few cases where we have asserted the privilege, it has never been because of damaging information, but has been dictated by other factors, such as confidential information about other matters which might have become exposed if the privilege was waived.

Meet with your beneficiary ASAP.

By stepping forward and attempting to correct the breaches, or at least acknowledging them, the fiduciary has a better chance of avoiding litigation. To some beneficiaries, the hiding of information, the ducking of their calls, and the fiduciary's indifference are like kerosene on a fire, fueling anger which often triggers litigation. Simultaneously with, or shortly after, the disclosure of information that will inform the beneficiaries of a breach, the fiduciary should meet with the beneficiaries or, at least communicate directly with them. Depending on the type of breach, and whether or not the damages have been mitigated, many beneficiaries are willing to forgive, especially if it is a family member or a close friend and the relationship is still sound. Even if there is significant loss, the beneficiary may not be of a mind to throw good money after bad by pursuing litigation; he may want to avoid the hassle of litigation; or, believe it or not, he may be willing to chalk it up to a mistake or just bad judgment.

In our experience, fiduciary litigation has more often been initiated or expanded because of the lack of communication or miscommunication than by the fiduciary stepping forward with hat in hand. That lack of communication ultimately leads to an inquiry, usually with the assistance of counsel, and that counsel then exposes more problems. While communication is certainly not the answer to every problem (such as a fiduciary looting all or most of the assets) it will rarely hurt.

Mitigate the damage immediately.

1. Repay self-dealing loans
2. Cancel self-dealing purchases
3. Refund excessive compensation

One of the first things your client should do is mitigate the damages – repay the loans, refund the excessive fees, etc. If it is not too late, unwind any potentially damaging self-dealing transactions that the fiduciary entered into with the trust, partnership, etc. Unfortunately, in many cases, when the fiduciary has taken money wrongfully, he has little left to pay back – that's usually why she took it in the first place. Of course, the fiduciary may not want to do any of these. Stress the importance, explain the downside risks, and make sure he understands that his failure to make restitution may make a lawsuit inevitable or even expose him to criminal prosecution. If the money or property is restored, it is much less likely that criminal prosecution will follow, and you probably eliminated the case's attractiveness to a lawyer looking for a contingent fee.

Don't retaliate.

It is amazing how many fiduciaries fall into these traps. Each of these actions is an additional breach of fiduciary duty. If the fiduciary didn't have a problem before, he is creating one. Some take this step because they think they will beat the beneficiary into submission or scare her off. Others do not want to give the beneficiary the financial resources to take any legal action. Still others may believe that the fiduciary relationship is about them and their role, and not about the beneficiary or the fiduciary's obligation to the beneficiary. Whatever the rationale, these acts usually have the opposite effect of what the fiduciary hopes to accomplish.

i.) Making it difficult to get information

The books and records created by the fiduciary are not solely his or hers. They belong to the entity or are held for the benefit of beneficiaries. Often, the fiduciary will try to withhold information from the beneficiary or restrict the beneficiary's access as punishment for bringing a lawsuit. The Supreme Court has confirmed that the fiduciary's duty of disclosure continues even during litigation between the beneficiary and the fiduciary. *See, generally, Huie v. DeShazo*, 922 S.W.2d at 924 (during litigation, information can be sought in an informal fashion rather than through formal discovery). Counsel for some fiduciaries incorrectly take the position that requests for information must be pursued through formal discovery rules rather than under equitable rules. Some trial judges have agreed and have required the information to be formally requested under the Rules of Civil Procedure. No matter how the information is requested, it needs to flow freely. If the beneficiary is already angry enough or suspicious enough to hire a lawyer, withholding information will only make the beneficiary madder and more suspicious, and the fiduciary can be almost certain that he will repeatedly hear at trial about the difficulties in getting information. Worse, the fiduciary's litigation counsel will have his perceived integrity undermined because he helped the fiduciary withhold or slow-play the information.

ii.) Making beneficiaries jump through hoops for their regular distribution

Once litigation has been threatened or initiated, some fiduciaries try to restrict the flow of money to their beneficiary. Sometimes this is just a retaliatory tactic because the fiduciary is mad, and sometimes it is designed to restrict the beneficiary's ability to fund the lawsuit. Be sure to counsel your client how she should treat a hostile beneficiary. In particular, the regular flow of money to the beneficiary should continue, unless there is a clear and compelling reason to change it.

iii.)Cutting them off entirely.

Cutting off distributions virtually guarantees a lawsuit, and will definitely make the case more appealing to a plaintiff's lawyer. In rare cases, such as where the beneficiary is too weak, tired, or afraid to stand up to the fiduciary, this strategy could work, but it is risky. The more likely result is that this type of retaliation becomes the subject of a new claim, and the beneficiary and his lawyer become eager to drag the retaliating fiduciary before a jury, with an ugly result for the fiduciary usually following.

iv.)Kicking them out

We have also seen cases where, in retaliation for asking questions, the beneficiary is removed as a co-trustee, from a trust committee, from the family business, or from a similar position. Or, the managing partner or other partners try to oust the inquisitive partner from the partnership. These are equally bad ideas. There is no question that when tension has arisen between a fiduciary and a beneficiary, a "divorce" is a great idea, but it is almost always the better course to wait for a resolution that includes a separation, as compared to forcing it down the throat of a disgruntled beneficiary or partner.

Criminal exposure.

Most fiduciaries have no idea that their conduct can create criminal exposure. Furthermore, the punishment can be very harsh – how does incarceration for 99 years sound for borrowing $250,000? The Texas Penal Code has sections that apply specifically to fiduciaries, in particular bribery (Penal Code §32.43) and misapplication of fiduciary funds (Penal Code §32.45). In cases involving over $20,000, both crimes are state jail felonies. Most fiduciaries do not realize their criminal exposure, and most trial lawyers seem to miss it too.

A. Texas Penal Code §32.43

Commercial Bribery
(a) For purposes of this section:
(1) "Beneficiary" means a person for whom a fiduciary is acting.
(2) "Fiduciary" means:
(A) an agent or employee;
(B) a trustee, guardian, custodian, administrator, executor, conservator, receiver, or similar fiduciary;
(C) a lawyer, physician, accountant, appraiser, or other professional advisor; or
(D) an officer, director, partner, manager, or other participant in the direction of the affairs of a corporation or association.

(b) A person who is a fiduciary commits an offense if, without the consent of his beneficiary, he intentionally or knowingly solicits, accepts, or agrees to accept any benefit from another person on agreement or understanding that the benefit will influence the conduct of the fiduciary in relation to the affairs of his beneficiary.

(c) A person commits an offense if he offers, confers, or agrees to confer any benefit the acceptance of which is an offense under Subsection (b). [Emphasis added.]

(d) An offense under this section is a state jail felony.

(e) In lieu of a fine that is authorized by Subsection (d), and in addition to the imprisonment that is authorized by that subsection, if the court finds that an individual who is a fiduciary gained a benefit through the commission of an offense under Subsection (b), the court may sentence the individual to pay a fine in an amount fixed by the court, not to exceed double the value of the benefit gained. This subsection does not affect the application of Section 12.51(c) to an offense under this section committed by a corporation or association.

B. Texas Penal Code §32.45

Misapplication of Fiduciary Property or Property of Financial Institution

(a) For purposes of this section:

(1) “Fiduciary” includes:
(A) a trustee, guardian, administrator, executor, conservator, and receiver;
(B) an attorney in fact or agent appointed under a durable power of attorney as provided by Chapter XII, Texas Probate Code;
(C) any other person acting in a fiduciary capacity, but not a commercial bailee unless the commercial bailee is a party in a motor fuel sales agreement with a distributor or supplier, as those terms are defined by Section 153.001, Tax Code; and
(D) an officer, manager, employee, or agent carrying on fiduciary functions on behalf of a fiduciary.

(2) “Misapply” means deal with property contrary to:
(A) an agreement under which the fiduciary holds the property; or
(B) a law prescribing the custody or disposition of the property.

(b) 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. [Emphasis added.]

(c) An offense under this section is:11

(1) a Class C misdemeanor if the value of the property misapplied is less than $20;
(2) a Class B misdemeanor if the value of the property misapplied is $20 or more but less than $500;
(3) a Class A misdemeanor if the value of the property misapplied is $500 or more but less than $1,500;
(4) a state jail felony if the value of the property misapplied is $1,500 or more but less than $20,000;
(5) a felony of the third degree if the value of the property misapplied is $20,000 or more but less than $100,000;
(6) a felony of the second degree if the value of the property misapplied is $100,000 or more but less than $200,000; or
(7) a felony of the first degree if the value of the property misapplied is $200,000 or more.

(d) An offense described for purposes of punishment by Subsections (c)(1)-(6) is increased to the next higher category of offense if it is shown on the trial of the offense that the offense was committed against an elderly individual as defined by Section 22.04. [Emphasis added.]

(e) With the consent of the appropriate local county or district attorney, the attorney general has concurrent jurisdiction with that consenting local prosecutor to prosecute an offense under this section that involves the state Medicaid program.

C. A question of magnitude, type, and family involvement.

In our experience, district attorneys rarely pursue these cases, seeing them as ordinary civil matters with the same remedies and collection tools available as to any plaintiff. This seems especially true when the trustee and beneficiaries are related. We have also been told that prosecuting these cases is not a priority for the public welfare, particularly if the case involves one rich family member against another. That can be frustrating when the amount of damages is hundreds of thousands or millions of dollars.

Nonetheless, you need to carefully consider whether your client has any criminal exposure, even if remote. Fiduciary cases are often emotionally charged, and it is not uncommon for the beneficiary to seek prosecution, even in tandem with their civil action. Thus, the prospect of criminal exposure may answer the question of whether to dig in or cut and run.

Whether a D.A. will get interested seems to be a question of magnitude, type, and family involvement. The more serious the transgression - not just money, but other considerations like taking from a minor or the elderly - the more likely the criminal exposure. Some fiduciary misdeeds (such as using the money personally or taking a kickback) are obvious violations of the Penal Code, and some are less clear (such as borrowing money with the intent to repay but becoming unable to repay). You need to weigh these factors with your client because the exposure to possible criminal prosecution may make a quick settlement, regardless of cost, more palatable to the client.

Seeking criminal prosecution is a likely option when the beneficiaries have little money to hire a lawyer or collection from the fiduciary seems unlikely. While the likelihood of prosecution is not high, if a prosecutor does get interested, your fiduciary had better look out. The government will likely have better collection tools (in particular, the threat of incarceration) at its disposal than the civil lawyer, with restitution as a major goal of prosecution. In cases where we have seen criminal prosecution, restitution has always been an element of any plea bargain or probation. So, if the beneficiary cannot afford to hire a lawyer, or cannot get a lawyer interested in a contingent fee, by involving the district attorney he may recover some money in addition to making life miserable for your client.

Another issue that should be considered is where jurisdiction may lie. If the settlor/testator lived primarily in one county, the fiduciary in another, and all of the beneficiaries in yet another, your client may not be off the hook just because one prosecutor turns it down. The beneficiary's lawyer may contact prosecutors in multiple counties if the first one declines. If your client may become a prosecution target, you should consider that there may be more than one bloodhound in the hunt. Here's an example: a will was probated in Kaufman County creating a testamentary trust; the trustee lived in Liberty County and administered the trust there; many of the beneficiaries, however, lived in Dallas County; the trustee lent his Montgomery County company most of the trust funds with no ability to repay. The Liberty County D.A. was not interested, but the Dallas County D.A. prosecuted and obtained a plea bargain which included probation conditioned on, among other things, restitution to the beneficiaries.

Criminal prosecution may not be very likely, but the consequences may be devastating and must be considered.

Is There a Get Out of Jail Free Card?

A. Insurance and Indemnification.

Your client probably will not have insurance but it must not be overlooked. Insurance for breach of fiduciary duty claims can be found in fiduciary liability policies, D&O coverage, professional liability policies, and, occasionally, commercial general liability policies. Applicability of coverage may be an issue and is probably barred if the covered events include intentional acts or bad faith, etc. But the carrier will often tender a defense, with the question of coverage to be resolved later. If the fiduciary has insurance covering his actions, the policy most likely has a "notice of suit provision" requiring the fiduciary to notify the insurance carrier of any lawsuit or potential claim. The purpose of a "notice of suit provision" in an insurance policy is to enable the insurer to investigate the circumstances of the policy-invoking incident so that the insurer has adequate time to prepare to defend against claims. *See Blanton v. Vesta Lloyds Ins. Co.,* 185 S.W.3d 607, 611-12 (Tex. App.-Dallas 2006, no pet.) (citing *Employers Cas. Co. v. Glens Falls Ins. Co.,* 484 S.W.2d 570, 575 (Tex. 1972)). Failure to notify can result in the insurance carrier denying coverage, which will probably result in yet another lawsuit. The crucial inquiry in determining whether an insurer was prejudiced as a matter of law is whether the insurer's ability to defend against the claim was irreparably impaired by the insured's failure to comply with the notice-of-suit provision. *See Id.* at 612 (citing 13 Couch on Insurance §186:14 (3d ed. 2005)). To protect himself, the fiduciary should notify his insurance carrier as soon as possible, even if the fiduciary believes the claim is frivolous. [Note, that homeowner's policies may provide insurance to a volunteer – i.e., unpaid, fiduciary.]

Indemnification is another protection that may be found in the trust instrument, the partnership agreement, or even corporate bylaws. There are also some indemnification rights in partnership and corporation statutes. It is rare that insurance and indemnification will be of help where the fiduciary has simply stolen the money; but when arguments can be made that the conduct was negligent (like a self-dealing loan gone bad), insurance or indemnification may help.

B. Contractual modifications of your [the fiduciary's] duties.

1. Find authorization in the documents for the actions your client [the fiduciary] took

2. Find relief not only in the exculpatory clauses but in other language too

Trusts have long included exculpatory clauses which provide considerable protection for the fiduciary. But modern trusts often contain specific modifications of fiduciary duty. Besides a broad exculpatory clause, there may be specific directives authorizing the action, or other specific exculpatory language with respect to specific actions.

The Trust Code expressly allows a settlor to contractually limit the trustee's duty. *See* Texas Property Code §113.059. Modern trusts frequently contain several different clauses offering

protection for the fiduciary. Most common is the exculpatory clause. However, the presence or absence of such a clause is never the end of the inquiry. Frequently, administrative provisions, usually found in that to-painful-to-read boilerplate, will offer relief to the trustee for various actions. For example, the trustee might be specifically relieved of liability for retaining certain unproductive property, or for holding a particular stock or failing to diversify. Often this language is written as a directive or a modification of the fiduciary's duty, as opposed to a statement relieving a trustee of liability. Consider the trustee who was directed to hold stock in a certain company that became bankrupt on the trustee's watch. In that circumstance, the clause may provide considerable protection to the trustee. While such a clause does not guarantee that the trustee is immune from liability (since a trustee must always act reasonably), it significantly weakens the plaintiff's case and reduces the settlement value. Depending on the circumstances and the good faith of the trustee, it may fully protect him.

Whether you are relying on a directive, a specific exculpatory clause, or a broad exculpatory clause, one should be prepared for the beneficiary to claim that provision must be narrowly construed and does not apply, or that it is void as against public policy or invalid for other reasons. Examples of clauses that might be void as against public policy are clauses that attempt to exonerate actions taken in bad faith, recklessly or intentionally. *See, e.g.,* Texas Property Code §114.007. Although this statute specifically applies to trusts, it can easily be extrapolated to reflect the public policy of Texas.

Damn the Torpedoes and Full Speed Ahead

A. Mount your defenses.
Although the usual list of defenses are often available to a fiduciary, his duty of full disclosure can limit his ability to use them. In almost every instance, the case law, and even some statutes, require full and complete disclosure of material facts. *See* e.g. *Montgomery v. Kennedy*, 669 S.W.2d 309, 313 (Tex. 1984); Texas Property Code §114.005 (a beneficiary acting "on full information" may relieve a trustee). Thus, in addition to meeting the regular burden of proof for a fiduciary's defenses, one must usually prove that the fiduciary disclosed all material facts.

i.) Consent and Ratification

Texas Trust Code §114.005 specifically provides that a beneficiary "acting on full information may relieve a trustee from any duty, responsibility, restriction, or liability." (An exception applies to certain liabilities imposed on corporate trustees.)

Burnett v. First Nat. Bank of Waco, 536 S.W.2d 600, 602 (Tex. Civ. App.-Waco 1976, writ ref'd n.r.e.) is an example of ratification where a competent adult beneficiary signed off on the act complained of. In *Burnett*, letters and instruments delivered to the trustee bank by an adult beneficiary of a revocable trust established the beneficiary's consent, acquiescence, ratification, and release of the trustee's loans from the trust to entities controlled by the beneficiary and to persons associated with the beneficiary, the trustee bank was not liable to the beneficiary for the alleged failures to perform discretionary functions in making the loans. *Burnett v. First Nat. Bank of Waco*, 536 S.W.2d 600 (Tex. Civ. App.-Eastland 1976, writ ref'd n.r.e.) (citing 128 A.L.R. 6 (1940)).15

"It is a well-established rule in the law of trusts, that a beneficiary may, by his consent, acquiescence, or ratification, be estopped to complain of a breach of trust by the trustee. In other words it would seem that the principles of estoppel apply to cestuis que trust just as fully as to persons in other relationships . . ."

"Ratification is the adoption or confirmation by a person, with knowledge of all material facts, of a prior act that did not then legally bind that person and which that person had the right to repudiate." *Avary v. Bank of America, N.A.,* 72 S.W.3d 779, 788 (Tex. App.-Dallas 2002, pet. denied).

The Restatement (Second) of Trusts §218 tells us that a ratification by a beneficiary will not be valid if the beneficiary did not know of his rights or of material facts which the trustee knew, or should have known, because the fiduciary's duty of disclosure is so fundamental. The general rule is that the fiduciary cannot take benefit from a circumstance in which full disclosure has not been made.

Restatement (Second) of Trusts §218: Discharge of Liability by Subsequent Affirmance –

(1) Except as stated in Subsection 2, if the trustee in breach of trust enters into a transaction which the beneficiary can at his option reject or affirm, and the beneficiary affirms the transaction, he cannot thereafter reject it and hold the trustee liable for any loss occurring after the trustee entered into the transaction.

(2) The affirmance of a transaction by the beneficiary does not preclude him from holding the trustee liable for breach of trust, if at the time of the affirmance (a) the beneficiary was under an incapacity; or (b) the beneficiary did not know of his rights and of the material facts which the trustee knew or should have known and which the trustee did not reasonably believe that the beneficiary knew; or (c) the affirmance was induced by improper conduct of the trustee; or (d) the transaction involved a bargain with the trustee which was not fair and reasonable.

ii.) Waiver

[R]atification and waiver invoke the same factual elements: (1) there must be full knowledge of the known right which vitiates a prior act, and (2) there must be an intentional relinquishment of the known right, or intentional recognition of the prior act, depending upon the user's choice of words. While to relinquish is the gist of "waiver" and to approve is the gist of "ratification," to relinquish a known right is to give validity to the prior act and to approve a prior act is to relinquish a known right.

Caldwell v. Callender Lake Prop. Owners Imp. Ass'n, 888 S.W.2d 903, 910 (Tex. App.-Texarkana 1994, writ denied) (quoting *Jordan v. City of Beaumont,* 337 S.W.2d 115, 118 (Tex. Civ. App.-Beaumont 1960, writ ref'd n.r.e.)).

iii.)Estoppel

There are several cases in which beneficiaries have been held to be estopped from asserting a claim against a trustee because of the beneficiary's conduct. *See e.g., Beaty v. Bales*, 677 S.W.2d 750 (Tex. App.-San Antonio 1984, writ ref'd n.r.e.) and *Langford v. Shamburger*, 417 S.W.2d 438 (Tex. Civ. App.-Fort Worth 1967, writ ref'd n.r.e.).

Promissory Estoppel
The elements of promissory estoppel are: (1) a promise, (2) foreseeability of reliance by the promisor, (3) substantial and reasonable reliance by the promise to its detriment, and (4) enforcing the promise is necessary to avoid injustice. *Sipco Servs. Marine v. Wyatt Field Serv. Co.,* 857 S.W.2d 602, 605 (Tex. App.-Houston [1st Dist.] 1993, no writ).

Equitable Estoppel
The doctrine of equitable estoppel requires (1) a false representation or concealment of material facts; (2) made with knowledge, actual or constructive, of those facts; (3) with the intention that it should be acted on; (4) to a party without knowledge or means of obtaining knowledge of the facts; (5) who detrimentally relies on the representations. *Johnson & Higgins of Texas, Inc. v. Kenneco Energy, Inc.,* 962 S.W.2d 507, 515–16 (Tex. 1998).

Quasi-Estoppel
This long-standing doctrine precludes contradictory positions: it precludes a person from asserting, to another's disadvantage, a right inconsistent with a position previously taken. *Lopez v. Munoz, Hockema & Reed, L.L.P.,* 22 S.W.3d 857, 864 (Tex. 2000); *see Schauer v. Von Schauer,* 138 S.W. 145, 149–50 (Tex. Civ. App.-Austin 1911, writ ref'd) ("Where a person has, with knowledge of the facts, acted or conducted himself in a particular manner, or asserted a particular claim, title, or right, he cannot afterwards assume a position inconsistent with such act, claim or conduct to the prejudice of another."). The doctrine applies when it would be unconscionable to allow a person to maintain a position inconsistent with one in which he acquiesced. *Lopez,* 22 S.W.3d at 864; *Atkinson Gas Co. v. Albrecht,* 878 S.W.2d 236, 240 (Tex. App.-Corpus Christi 1994, writ denied) ; *Vessels v. Anschutz Corp.,* 823 S.W.2d 762, 765–66 (Tex.App.-Texarkana 1992, writ denied) . Unlike equitable estoppel, quasi-estoppel does not require a showing of a false representation or detrimental of execution, a valid release may also encompass unknown claims and damages that develop in the future. *Id.*

If the fiduciary negotiated the release with the beneficiary, he must usually show more than just the existence of a release. In *Keck,* 20 S.W.3rd at 699, the court held that it was the fiduciary's burden to prove that the release agreement he negotiated was fair and reasonable, and that the beneficiary was informed of all material facts relating to the release.

vi.)Limitations

Actions for fraud and breach of fiduciary duty are governed by a four-year limitations period. Tex. Civ. Prac. & Rem. Code §16.004(a)(4).

Watch out for the "discovery rule", which defers accrual of a cause of action in two categories of cases.

The first category consists of cases in which the nature of the injury is inherently undiscoverable and the evidence of injury is objectively verifiable. In these cases, accrual is deferred until the plaintiff knows or in the exercise of reasonable diligence should know of the wrongful act and the resulting injury. . . . The second category consists of cases involving fraud. In these cases, accrual is deferred through a species of equitable estoppel known as fraudulent concealment. The defendant is estopped from relying on the statute of limitations until the plaintiff learns of the right of action or should have learned of it through the exercise of reasonable diligence.
Advent Trust Co. v. Hyder, 12 S.W.3d 534 (Tex.App.-San Antonio 1999, pet. denied) (citations omitted).

In *Freuden v. Hibernia National Bank*, 2009 WL 2045158 (Tex.App.-Beaumont, 2009, pet. denied), the decedent left a testamentary trust for her children and their issue. The will was probated in 1994. A son who predeceased Decedent had adopted two children who were included in the definition of "issue." The trustee did not make distributions to the adopted children, and one adopted child sued in 2004 claiming that the discovery rule tolled the limitations defense. The trial court granted summary judgment in favor of the trustee on limitations, and the court of appeals affirmed, stating that the adopted child knew of the grandmother's death in 1994, attended the funeral, and was told by her mother that she had inherited some money. *Id.* at *3. Therefore, the adopted child knew or should have known of the wrongdoing and limitations had not tolled.

vii.) Exculpatory language

The most common defense used by fiduciaries is reliance upon exculpatory language. As discussed above, exculpatory language may be specific, such as a release of liability for holding unproductive property, or it may be broad, such as a blanket relief for negligence. The typical exculpatory provision exonerates a fiduciary for simple negligence or for actions taken by him in good faith. Consistent with the common law, most exculpatory clauses now specifically provide that exculpation does not apply to any actions taken in bad faith or actions that were willfully or grossly negligent. Texas Property Code §114.007 specifically places this limitation on exculpatory clauses in trusts.

viii.) There is no such thing as "absolute discretion"

Some lawyers believe that, if the fiduciary was granted "absolute or sole and exclusive discretion" in making his decision, he is bullet proof. But in reality, the fiduciary is still accountable for an abuse of his discretion and he is still required to act reasonably. *First Nat'l Bank v. Howard*, 229 S.W.2d 781, 784-85 (Tex. 1950). Discretion is never defined as "I can do whatever I want." Many Texas cases hold that a trustee is bound by his many fiduciary duties in exercising discretion.

A trustee vested with discretionary power to distribute a fund in whole or in part is bound to use reasonable prudence. The possession of full power or wide discretion by a trustee means the kind

of power and discretion which inheres in a fiduciary relation and not that illimitable potentiality which an unrestrained individual possesses respecting his own property. *Cruse v. Reinhard*, 208 S.W.2d 598, 613 (Tex. Civ. App.-Beaumont 1948, writ refused n.r.e.).

Broad and discretionary powers must be exercised in good faith. *Zweig v. Zweig,* 275 S.W.2d 201, 204 (Tex. Civ. App.-San Antonio 1955, writ refused n.r.e.). While the terms "discretion" and "absolute discretion" may have somewhat different meanings, both imply an exercise of judgment in good faith. A trustee vested with absolute discretion is not authorized to act arbitrarily. *Frost National Bank v. Boyd,* 188 S.W.2d 199, 206 (Tex. Civ. App.-San Antonio 1945), *affirmed,* 145 Tex. 206, 196 S.W.2d 497 (Tex. 1946).

ix.)Reliance on advice of counsel

Unless specifically allowed in the trust instrument or other agreement, reliance on advice of counsel is usually not a defense to a breach of fiduciary duty. However, it is a mitigating factor both to the breach and to punitive damages. Some documents specifically relieve a fiduciary for actions taken in good faith or on the advice of counsel. In the absence of such a clause, however, reliance on the advice of counsel can still be helpful to convince a fact finder that there was no breach or that, if there was a breach, it was not reckless, malicious, etc. In other words, it may help prevent a finding of liability or, more likely, prevent a finding that would support punitive damages. However, the flip side is that a party who wants to argue reliance on the advice of counsel must waive the attorney-client privilege, at least with respect to the matters at issue. In *DeWitt & Rearick, Inc. v. Ferguson*, 699 S.W.2d 692 (Tex.App.-El Paso 1985, original proceeding), *disapproved on other grounds*, *Owens Corning Fiberglass Corp. v. Caldwell*, 818 S.W.2d 749, 750 (Tex. 1991), the court treated an advice of counsel defense as an offensive use of the attorney-client privilege. The offensive use doctrine typically applies when a party seeks affirmative relief and attempts to claim a privilege to shield evidence that might weaken or defeat that party's claims. *See Republic Ins. Co. v. Davis*, 856 S.W.2d 158, 161 (Tex. 1993). If a fiduciary wants to assert advice of counsel, she must recognize that she is opening the door to a privilege waiver.

x.) No damages

Most breaches of fiduciary duties cause no actual damage to the beneficiary. Many lawyers believe that damages are a necessary element of a breach of fiduciary duty claim, but that is not true. And, in situations where there are no actual damages, there may still be significant financial relief available to the beneficiary. For example, although the beneficiary may have suffered no damage in a self-dealing case, the fiduciary may be forced to disgorge all profits that the fiduciary gained as a result of the self-dealing. In *Slay v. Burnett Trust*, 187 S.W.2d 377 (Tex. 1945), the court discussed disgorgement of profits by a fiduciary and held that "it is well settled that in a suit of this kind recovery may be had by the beneficiary even though he has suffered no damage and even though the trustee may have acted in good faith." *Id.* at 389.

Some of our cases have resulted in the self-dealing fiduciary paying the highest rate allowed by law instead of a market rate. For example, where a fiduciary borrowed money from his trust and

paid a market interest rate, the court forced the fiduciary to pay the highest rate allowed by law (18%) rather than the lower market rate.

One of the hottest trends in Texas is to seek "fee forfeiture". Since *Arce v. Burrow*, 997 S.W.2d 229 (Tex. 1999), the remedy has gained considerable prominence, especially in cases against attorneys. A fiduciary who has breached his fiduciary duty to a beneficiary may find herself forfeiting fees even when no damage was caused to the beneficiary or to the trust. NOTE: the amount of fee forfeiture is typically left to the discretion of the court.

B. The cost of defense: pay it out of the corpus or from the fiduciary's own pocket?

One of the benefits of being a fiduciary is the prospect of paying for the cost of defense from the fiduciary funds. But is that really a good idea? This decision can save or scorch your client. The pecuniary advantage of paying the cost of defense from the fiduciary pot is obvious, but the advantages are potentially much more than the financial relief it gives your client. For many beneficiaries, having to spend their own funds - or even just the potential of it - will cause them to settle, maybe cheaply, or even to walk away from the litigation. In light of the continuing drain on the fund imposed by the fiduciary's legal fees, the beneficiary may be more willing to live with a quick fiduciary resignation and a release rather than pursue damages. On the other hand, the act of a breaching fiduciary continuing to raid the pot to pay for his or her defense may be the last straw, and energize the beneficiary to go after the fiduciary for everything she can.
Whether to charge the fund/trust/partnership with the cost of defense is one of the toughest decisions a fiduciary and counsel must make. Sometimes litigation expense is the single most important factor that precipitates a settlement. On the other hand, a fiduciary who has breached his fiduciary duty and continues to use the assets to defend his illicit conduct may be committing a new breach of fiduciary duty. In some situations it is best, if the fiduciary can afford it, to pay the fees personally to avoid additional breaches and avoid escalating the litigation. On the other hand, the prospect that the pot will dwindle even more because of the fiduciary's legal fees has led to many a settlement. All of the factors and the circumstances must be carefully analyzed to make the best decision.

C. Should the fiduciary file first if a lawsuit is inevitable?

Once you determine that a lawsuit is coming, weigh the advantages of filing the action first. There are many good reasons to file first. Most important is that it may give you the right to open and close at a trial. Although a fiduciary may have that opportunity anyway if he has the burden of proof, filing first may help solidify that position. Second, there may be opportunities to pick a more favorable venue, especially if there are multiple venue options. For example, in trust cases where there is a single non-corporate trustee, trust venue statutes allow the suit to proceed in (1) any county in which the trust situs has been maintained in the previous four (4) years, or (2) the county of the trustee's residence. So you may have an opportunity in your choice of venue to avoid a traditionally damage-happy county. One can even consider the possibility of relocating the trust situs to a more favorable county in anticipation of litigation. A third advantage is that the fiduciary may be able to pick the court itself, such as filing in a statutory probate court, if one is available in any of the venue-appropriate counties, to obtain a judge with more experience with fiduciary cases.

An out-of-state trustee may be able to choose between states when filing the lawsuit, or move a pending action to a more convenient forum with jurisdiction. The choice of state can be exercised for many reasons: it is where the case truly belongs; it is the most convenient forum due to location of the parties and witnesses; or it might create another barrier for the plaintiff. As an example of the latter: a beneficiary signs a contingent fee agreement with a Texas lawyer, who sues the Florida trustee in Texas state court. The trustee might try to move the case to Florida, and if successful, the beneficiary may have to start over again, and could be in an even worse position if still obligated to pay some of the recovery to the Texas lawyer while trying to attract a new Florida lawyer.

Examples of some of the actions a fiduciary can use to trigger the litigation are petitions to approve accountings, petitions for instructions, or declaratory judgment actions.

D. Is arbitration available?

Arbitration is potentially a great option if it is available. We have seen several situations where arbitration produced surprisingly good results for fiduciaries who obviously breached their fiduciary duties. Arbitration also seems to have a chilling effect on the expectations of plaintiffs, which may also make the case easier to settle. Arbitration clauses are turning up in wills, trusts, and partnership agreements, among other contracts. Such a clause is usually valid in a partnership agreement and in other contractual agreements. More problematic is whether an arbitration clause in a trust or will is valid. In the recent case of *Rachal v. Reitz*, 347 S.W.3d 305, 313-14 (Tex.App.-Dallas 2011, pet. filed), the Court of Appeals held unenforceable an arbitration clause of a trust requiring the beneficiaries to arbitrate disputes with the trustees. The court reasoned that the beneficiaries could not be bound to arbitration because they never contractually agreed to relinquish their right to litigate. A four judge dissent opined that, because the beneficiaries effectively accepted the trust, they should be bound by the arbitration clause. It seems logical that a settlor or testator could condition the acceptance of a gift under the will or trust upon the acceptance of arbitration as a remedy. The trust in *Rachal* did not go that far. *Rachal* could also be distinguished in the situation where the beneficiaries are suing a successor trustee and the beneficiaries personally entered into a separate contract with the trustee.

E. The Parties.

The issue of parties ordinarily is simple – usually you have a plaintiff and a defendant. In fiduciary litigation, however, especially trust and estate litigation, it is not so simple. First, consider the capacity in which your client has been sued or in which capacity your client should appear if he is initiating the lawsuit. Plaintiffs frequently sue fiduciaries as “trustee”, “executor”, “partner”, etc. “Partner” is not a separate status from the partner’s individual status. But when a fiduciary serves as trustee or executor, he acts in a capacity different from his individual capacity. If litigation seeks to bind him in his fiduciary capacity, he must be sued and served in that capacity. On the other hand, if the beneficiary seeks to charge the fiduciary, individually, with damages, the fiduciary must be named in his individual capacity, not his fiduciary capacity. *In Re Estate of Spivey*, 2000 WL 4397 (Tex.App.-Texarkana, no pet.). It is a common error for

parties to assume that a damage award against "John Doe" as trustee is a damage award against "John Doe" as an individual. It's not.

Many lawyers also sue in the name of the trust or the estate. A trust and an estate exist only through a fiduciary. A trust or an estate is not a legal entity apart from its fiduciary. In other words, the trustee is the trust and the executor is the estate. So litigation by or against an "estate" is technically improper. *See Henson v. Estate of Crow*, 734 S.W.2d 648 (Tex. 1987) (executor must be sued rather than the "estate"); *Ray Malooly Trust v. Juhl*, 186 S.W.3d 568 (Tex. 2006) (trustee must be sued rather than the "trust"). If a plaintiff beneficiary seeks damages from your client in the trustee capacity, the beneficiary may be in for a surprise when the damage award is assessed against the trust's assets rather than the trustee's personal assets.

Likewise, when a fiduciary wants to be released from personal liability, any judgment, settlement, or release should also address his individual capacity; however, an exoneration of the trustee's conduct in a judgment also protects the fiduciary from personal liability for those exonerated matters.

Finally, it is important to have all of the beneficiaries who might sue your client joined in the litigation either personally, by virtual representation, or through a guardian ad litem (for example, a guardian ad litem appointed for unborn and unknown beneficiaries). If not, your client may find himself defending the exact same lawsuit brought by another beneficiary down the road. Co-fiduciaries also should always be joined in the lawsuit.

Many lawyers believe that downstream beneficiaries are always covered by virtual representation. That may usually be true, but, if there are conflicts between the beneficiaries, there can be no virtual representation. For example, there is often an inherent conflict between income and remainder beneficiaries because the income beneficiary naturally wants more income distributions and the remainder beneficiaries are usually better off if more of the income is retained in the trust. Thus, even though a plaintiff income beneficiary is also the parent of minor remainder beneficiaries, she may not be able to bind them by virtual representation because their interests are different. On the other hand, where the trustee has made off with some of the assets of the trust and the income beneficiary is simply trying to recover these assets or their value for the trust, then there probably is no conflict. Texas Property Code §115.013(c) lays out virtual representation rules in trust cases and is consistent with common law applicable in many other situations.

F. Who was damaged?

One of the most confusing aspects of fiduciary litigation is the determination of who was actually damaged by the breach of fiduciary duty. Most often the damage was caused to the entity or to the trust, in which case the claim for damage does not usually belong to the beneficiary. For example, if the trustee wrongfully took $1,000,000 from the corpus of the trust, the income beneficiary was not damaged by the $1,000,000 loss; the trust was. So the $1,000,000 damage award does not flow to the income beneficiary. This is an important distinction, because it can undermine the value of the plaintiff's case. If he or she is not going to receive the benefit, the beneficiary may be less likely to pursue the claim.

This can also have a chilling effect on plaintiff's counsel, especially those working for a contingency fee. Many breach of fiduciary duty cases are brought by plaintiffs who hire their counsel on a contingency fee. What happens when the damages go to the trust instead of the beneficiary? While the plaintiff and his counsel can argue that the common fund doctrine applies, or that the plaintiff acted derivatively, this outcome creates uncertainty for the plaintiff and his counsel (which is always a valuable tool in settlement). Another factor that can put pressure on the plaintiff and his counsel is a spendthrift provision in a trust which may impair the ability of the beneficiary to give a contingent fee. This writer is not aware of a case where a spendthrift clause was used to defeat a contingency fee, but the uncertainty of that issue has led to the negotiation of a lower fee. While lowering the plaintiff's counsel's potential fee may save the breaching fiduciary money, the more important goal is to undermine the counsel's vigor to prosecute the case.

G. Don't forget to designate responsible third parties and consider cross-actions.

Texas Civil Practices & Remedies Code §33.004 provides the option to designate responsible third parties as a way to spread some of the blame. This is not frequently used in fiduciary cases, but consideration should be given to whether some or all of the blame can be put on an empty chair. When you designate a responsible third party, you do not make them a party to the lawsuit. In other words, you can shift blame to a non-party without suing them. However, if you designate a responsible third party, there is a high probability that the third party will then be sued by the plaintiff. Therefore do not designate someone that you are not prepared to see sued.

This is a valuable tool in situations where it is clear that the plaintiff does not want to sue the designated third party. For example, there may be co-trustees – one who is a family member and one who is not. The beneficiary may be comfortable suing the non-family member, but uncomfortable suing the family member. In that situation it would be important to designate the co-trustee family member as a responsible third party. Lawsuits against third-parties and cross actions should be also considered, such as where the trustee was given bad advice by his lawyer, financial advisor, accountant, etc.

H. Is there an expert who can help?

Three types of experts can be particularly helpful. A fiduciary expert is the most important but also the most problematic. The cases are mixed on whether a fiduciary expert can testify, and more courts say "no" to fiduciary experts than "yes". But a fiduciary expert can help if the court will allow it. Even if the court is not likely to allow an expert, it may be helpful to have one for guidance and also to help soften the plaintiff beneficiaries. For example, if you have an expert who says there was no breach, or that the breach was only negligent as opposed to grossly negligent, then he may be able to take some of the wind out of the plaintiff's sail.

Accounting and damage experts are crucial. You need to be able to show that all of the money and property are accounted for, and you need to be able to respond to the plaintiff's damage expert with your own, more conservative calculation of damage (or better yet, an opinion of no damage at all).

I. Summary Judgment.

Motions for summary judgment can be especially helpful to narrow some of the broad and often duplicative collateral claims that are typically thrown at the fiduciary. If your client is obviously guilty of a breach of fiduciary duty, then there is probably little to gain on the summary judgment front other than eliminating some of the other causes of action. In the typical fiduciary case, a fiduciary defendant is not likely to be able to take advantage of a "no-evidence" summary judgment motion, even though he is the defendant, because he usually has the burden of proof, at least with respect to proving the fairness of his transactions.

J. The pattern jury charge.

If you are trying a fiduciary case to a jury, watch out for the current pattern jury charge (Texas Pattern Jury Charges, PJC 104.2 and 104.3). There is an ongoing effort to create a new set of pattern jury questions for different types of fiduciary cases by 2012. The current fiduciary duty questions and instructions are dangerous because they really apply only to self-dealing cases. Many lawyers view the pattern jury charge as the law of the land, and judges seem to look at them the same way. However, if you have a fiduciary duty case that does not involve self-dealing, or involves other breaches besides self-dealing, you need to be prepared to convince the judge that the questions and instructions in the TPJC are insufficient.

K. Trial by judge or jury?

The plaintiff generally decides whether your trial will to a judge or a jury. In instances where the plaintiff has not requested a jury trial, consideration should be given to whether the fiduciary should demand a jury. Most lawyers seem to believe that trial by a judge is a safer bet for a defendant. But for a breach of fiduciary duty case that is not always the case. First, if you are wrong about the judge, the client is dead and there is nothing left for an appeal, whereas if you are wrong about one juror, you can still prevail with the other jurors. Also, much about fiduciary duty law is counter-intuitive. This is especially true when fairness is technically not a defense to the breach. A juror, who brings emotion into the equation, may be more likely to find that fairness absolves a fiduciary of breach. Some rules that govern fiduciaries are harsh, and it is more likely that a judge will enforce those than a jury.

L. Mediate early and again before trial.

We recommend mediating almost immediately – preferably even before a lawsuit, if possible. The help of a mediator may be enough to facilitate a settlement based on the fiduciary's resignation or perhaps the termination of the trust or dissolution of the partnership. While time can be on the fiduciary's side (and we have seen many beneficiaries weaken as the cases drag on), there is always the danger that the case expands beyond control. Tenacious counsel or the other side will likely bring more breaches to light. If the case does not settle early, make sure that you mediate again before trial. [As a third party neutral in a position of power, a mediator is in the experience of the moderator of the panel often able to communicate even more clearly and forcefully to the clients the pros and cons of their positions and of going forward when compared to fashioning a resolution today and ending this dispute.]

M. Resolving the case.

Obviously, if your fiduciary has done wrong, a settlement is usually the best option. As mentioned, one of the difficulties with settling these cases is fulfilling the duty of disclosure. It is very difficult to ensure that a fiduciary will not be sued again unless he has disclosed all of the material facts relating to all of the various actions he can be sued for. Sometimes the fiduciary tries to settle before he has to fess up to more wrongdoing – he keeps quiet, settles, and then the beneficiary finds out about new claims and sues again. Any settlement agreement should include as much self-serving language for the fiduciary as the other side will allow, such as affirmative statements that the plaintiff has had the opportunity to investigate to his heart's content and has completed his investigation; or that the beneficiary has made the conscious decision not to require additional disclosure. Specific releases and waivers should be included, along with a disclaimer of reliance on any representations provided by the fiduciary.

It is important that as many beneficiaries as possible be joined in the settlement. It is wise to have settling beneficiaries acknowledge that they are also settling the claims of similarly-situated beneficiaries by virtual representation, even if guardians ad litem are appointed. The goal should be to make sure that everyone who could potentially sue the fiduciary is included in the settlement. If possible, the fiduciary should get an indemnification for any claims by other non-party or downstream beneficiaries.

It is also valuable if the settlement is submitted to the court and approved by a judgment. An agreed judgment is frequently issued in trust and estate cases, especially when minors are involved.

N. Time is probably on your [the fiduciary's] side.

Litigation can move really slow. In our experience, that has often proved advantageous to the fiduciary. Some beneficiaries cannot afford the long fight; others grow frustrated by the delay and by the fact that a fiduciary they cannot stand is still at the helm. Taking advantage of opportunities to slow the case down is more likely to help than hurt. Although it is more expensive for your client, and may stoke the fire of the plaintiff or give him more opportunities to build a better case, this strategy may be worth the risk, especially if the plaintiff appears weak-minded, under-funded, or overly eager to settle.

O. Bankruptcy.

A last resort may be bankruptcy. There may be value in consulting a bankruptcy attorney to determine if bankruptcy options could be helpful. However, it should be noted that breach of fiduciary duty claims are often non-dischargeable in bankruptcy.

1. Generally fraud (which is non-dischargeable) usually includes breach of fiduciary duties

Bankruptcy Code 523(a)(4)

Exceptions to discharge: (a) A discharge under section 727, 1141, 1228 (a), 1228 (b), or 1328 (b) of this title does not discharge an individual debtor from any debt. . . (4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny. . . .

Consider:

(c) (1) . . . the debtor shall be discharged from a debt of a kind specified in paragraph (2), (4), (6), or (15) of subsection (a) of this section, unless, on request of the creditor to whom such debt is owed, and after notice and a hearing, the court determines such debt to be excepted from discharge under paragraph (2), (4), or (6), as the case may be, of subsection (a) of this section.

CONCLUSION.

Administration: During the administration, before any disputes arise, suggest to the client that he, she, or it be responsive, provide information on a transparent basis, in a timely fashion, do not favor any beneficiary over others, and document for each beneficiary when and why discretionary authority is exercised. If the fiduciary hat becomes to difficult to wear or to balance if the fiduciary is also a beneficiary, recommend that your client resign. Recommend that your client always be professional.

Clouds on the Horizon; Drizzle in the Air: Tell your client to continue to be responsive, provide information on a transparent basis, in a timely fashion, treat all beneficiaries equally and fairly, consult regularly with an attorney, and not stick the fiduciary's head in the sand. Recommend that the client always be professional. Tell your client, "Do not retaliate. Do not write emails in the heat of passion over your integrity being challenged and make sure your attorney receives a copy of every email and letter you send. Consider a mediation. Consider resigning. Buy *Getting to Yes: Negotiating Agreement Without Giving In*, by Fisher, Ury, and Patton. There are problems that can be resolved through the legal process; there are others that cannot be. No attorney, judge, or jury can make a fiduciary or beneficiary change his, her, or its behavior. Resolution must be a business proposition and not person. Consider filing the first legal proceeding if it appears that court proceedings are inevitable, perhaps as an application to approve an accounting.

Proceedings in Court; Discovery; Go All the Way to Court or Settle? Anyone who has ever been involved in court proceedings knows that none fit into the hour-long tv show where issues appear, a lawsuit is filed, and by the end of the show someone wins and someone loses. Litigation is time-consuming and costly, both financially and emotionally. There is an ebb and flow to each proceeding and sometimes your client, who has read and marked up *Getting to Yes*, is ready to reach a resolution faster than the other side. Sometimes, the parties need to be able to tell their side/part of the story to a mediator before being ready to settle. And sometimes, a judge or jury becomes the only way to reach closure of any sort. During all this, the fiduciary must

continue to act in a fiduciary manner to all beneficiaries, both friendly and patently unfriendly. Some beneficiaries' counsel may seek to have the judge prevent the fiduciary from using assets under the fiduciary's purview from being used to pay attorneys' fees, and some judges will grant such a motion.

You, the attorney, have a unique ability to assist the fiduciary client, and also the beneficiary client, navigate disputes with and claims against a fiduciary. And, while doing so, the attorney faces the ethical challenge of representing the client to the best of his or her abilility while paying the attorney's own overhead and salary. Thus, when agreeing to represent a client and then continuing that representation, the attorney must consider the cost of doing so in terms of deferred payment and being so involved with this case that he or she finds it difficult to represent other clients and take on new clients.