WHAT DID YOU MEAN BY THAT?
TRUST LANGUAGE AND APPLICATION BY TRUSTEES

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I. INTRODUCTION

Clear and comprehensive trust fiduciary provisions are a vital part of the framework of an effective and enduring estate plan. They reduce the opportunity for interference. Furthermore, the more comfortable the fiduciary is with the scope of his or her role and the built-in protections, the greater the likelihood that he or she will continue to act in such capacity. But, the powers, duties, and protection of the fiduciary should be balanced with the rights and protection of the beneficiary.

The estate-planning attorney should discuss the potential options and conflicts with the client. And, because of the increase in the number of conflicts and the litigation over these types of provisions, the instrument should include, when possible, methods of addressing these conflicts. The instruments can address the conflicts in one of several ways. For example, the beneficiary or a committee can be given the power to remove and replace the trustee. The trust can give an impartial trust committee the power to address grievances, which a beneficiary may validly have against the trustee.

This article is not designed to be a technical review of all the substantive law involving trust provisions but, rather, a pragmatic discussion of these provisions as awareness and focus can be the key to eliminating potential problems and future litigation.

All references are to the Texas Property (Trust) Code unless otherwise specifically cited and all references to a trust instrument include any instrument that governs the administration of a trust, such as an revocable or irrevocable trust agreement, will, etc.

II. SOURCES OF GUIDANCE AND AUTHORITY

A. The Pecking Order

Trust law is primarily a function of state law. Whenever there is a dispute involving a trust governed by Texas law, state law will control. There are generally three sources of binding authority when construing a Texas trust. They include:

1) The trust instrument;
2) The Texas Trust Code; and
3) Texas common law.

In addition, there are a number of other sources that, depending on the facts and circumstances, may provide some guidance (albeit many times of no precedential value). They include:

1) The Restatement of Trusts;
2) The Uniform Trust Code; and
3) Legal Treatises.

B. Binding Authority

1. The Trust Instrument

It is well settled in Texas that the first principle of trust construction is to honor the intent of the settlor. Thus, the terms of a trust, as set forth in the governing instrument, generally govern. This principle has been recognized by Section 111.0035(b) of the Texas Trust Code that provides:

The terms of a trust prevail over any provision of this subtitle, except that the terms of a trust may not limit:

1) The requirements imposed under Section 112.031;
2) The applicability of Section 114.007 to an exculpation term of a trust;
3) The periods of limitation for commencing a judicial proceeding regarding a trust;
4) A trustee’s duty:
   (A) With regard to an irrevocable trust, to respond to a demand for accounting made under Section 113.151 if the demand is from a beneficiary who, at the time of the demand:
      (i) is entitled or permitted to receive distributions from the trust; or
      (ii) would receive a distribution from the trust if the trust terminated at the time of the demand;
   (B) To act in good faith and in accordance with the purposes of the trust; and
5) The power of a court, in the interest of justice, to take action or exercise jurisdiction, including the power to:
   (A) Modify or terminate a trust or take other action under Section 112.054;
   (B) Remove a trustee under Section 113.082;
   (C) Exercise jurisdiction under Section 115.001;
   (D) Require, dispense with, modify, or terminate a trustee’s bond; or
   (E) Adjust or deny a trustee’s compensation if the trustee commits a breach of trust.

TEX. PROP. CODE ANN. 111.0035(b) (Vernon 2007); as Amended by Acts 80th Legislature Ch. 451 § 2, effective June 16, 2007; see also Beaty v. Bales, 677 S.W.2d 750, 754 (Tex. App.—San Antonio 1984, writ ref’d n.r.e.)(when language of trust instrument is unambiguous and expresses intentions of settlor, trustee’s powers are conferred by instrument and neither court nor trustee can add or take away such power).
But, Texas Trust Code Section 111.0035(c) was recently adopted to add the following limitations on the settlor’s right to limit a trustee’s duty of disclosure:

The terms of a trust may not limit any common-law duty to keep a beneficiary of an irrevocable trust who is 25 years of age or older informed at any time during which the beneficiary:

1. Is entitled or permitted to receive distributions from the trust; or
2. Would receive a distribution from the trust if the trust were terminated.

TEX. PROP. CODE. 111.0035(c); as Amended by Acts 80th Legislature Ch. 451 § 2, effective June 16, 2007).

2. Texas Trust Code Section 101.001 et seq

As previously discussed, Texas has adopted the Texas Trust Code. See TEX. PROP. CODE ANN. 101.001 et seq. (Vernon 2007). The Texas Trust Code applies to all trusts governed by Texas law unless the trust indicates a clear intent to provide otherwise (and only to the extent that the provisions do not limit the matters set forth in Section 111.0035 discussed supra). Therefore, unless the terms of a trust validly provide otherwise, the Texas Trust Code governs:

1) The duties and powers of a trustee;
2) Relations among trustees; and
3) The rights and interests of a beneficiary.

See TEX. PROP. CODE ANN. 111.0035(a) (Vernon 2007).

3. Texas Common Law

The powers and duties of a trustee are also governed by common law to the extent (i) the trust instrument does not validly provide otherwise, and (ii) they are applicable and not inconsistent with the provisions of the Texas Trust Code. See TEX. PROP. CODE ANN. § 111.005 (Vernon 2007)(“If the law codified in this subtitle repealed a statute that abrogated or restated a common law rule, that common law rule is reestablished, except as the contents of the rule are changed by this subtitle.”)

C. Potential Sources of Guidance

1. Restatement of Trusts

Texas has not adopted the Restatement of Trusts and they are not binding in Texas. Nevertheless, they still provide some guidance when construing and interpreting a trust. See RESTATEMENT (SECOND) OF TRUSTS § 1 et seq (1959); RESTATEMENT (THIRD) OF TRUSTS § 1 et seq (2003). But care should be taken first to determine whether the applicable provision of the Texas Trust Code conflicts with the Restatement’s position. If so, the Restatement should be completely disregarded.

Furthermore, as between the Restatement (Second) of Trusts and Restatement (Third) of Trusts, Texas courts have considered and cited the Restatement (Second) of Trusts in a number of decisions, but they have only cited the Restatement (Third) of Trusts three times. See Keisling v. Landrum, 218 S.W.3d 737 (Tex.App.—Fort Worth 2007, pet. denied); Marsh v. Frost National Bank, 129 S.W.2d 174 (Tex.App.—Corpus Christi 2004, writ denied); Bergman v. Bergman Davison Webster Charitable Trust, 2004 WL 24968 (Tex.App.—Amarillo 2004, no writ)(not designated for publication). Time will tell if or how Texas courts will view the Restatement (Third) of Trusts.

2. Uniform Trust Code

Likewise, Texas has not adopted the Uniform Trust Code (in fact legislative history indicates certain provisions of the Texas Trust Code were enacted to expressly disavow any attempts to apply certain provisions) and it has no precedential value. Nevertheless, it also provides some guidance when drafting, construing and administering trusts. Approved in 2000 by the National Conference of Commission on Uniform State Laws, the Uniform Trust Code is the first codification of trust law. As of 2005, the Uniform Trust Code, with some variations, has been adopted by approximately fifteen states: Arkansas, District of Columbia, Kansas, Maine, Missouri, Nebraska, New Hampshire, New Mexico, North Carolina, Oregon, South Carolina, Tennessee, Utah, Virginia and Wyoming. See Robert T. Danforth, Article Five of the UTC and the Future of Creditors’ Rights in Trusts, 27 Cardozo L. Rev. 2551, 2554 (2006). And, several other states are in the process of considering its adoption. See Id.

III. FUNDAMENTAL DUTIES OF A TRUSTEE

A. Overview.

The Texas Trust Code states that “[t]he trustee shall administer the trust in good faith according to its terms and [the Texas Trust Code] . . . and shall perform all the duties imposed on trustees by the common law.” Tex. Prop. Code Ann. § 113.051 (Vernon Supp. 2010).

B. General Duties of a Trustee.

A trust involves a fiduciary relationship. William F. Fratcher, Scott on Trusts § 348 (4th Ed. 1989). Just as there is no single correct definition of what constitutes a fiduciary relationship, there are no hard and fast rules defining the duties of a trustee, and, to a great extent, the duties may overlap considerably. Just what is expected of a “fiduciary” may have been best summarized by Justice Cardozo in the case of Meinhard v. Salmon, in which he stated:
Many forms of conduct permissible in a workaday world for those acting at arms length are forbidden to those bound by fiduciary ties. A [fiduciary] is held to something stricter than the morals of the market place. Not honesty alone, but the punctilious of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the “disintegrating erosion” of particular exceptions. . . . Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd.

249 N.Y. 458, 164 N.E. 545-546, 62 A.L.R. 1 (1928); see also Langford v. Shamburger, 417 S.W.2d 438 (Tex.Civ.App.—Fort Worth 1967, writ ref’d n.r.e.). In addition, in the case of particular types of fiduciaries (such as trustees), their duties may be defined by the trust instrument and/or statutes that alter or negate certain fiduciary duties that would otherwise be imposed by Texas “common law.” Generally speaking, the duties of a fiduciary may be roughly categorized under four main headings:

- The duty of competence;
- The duty to reasonably exercise discretion;
- The duty of loyalty; and
- The duty to make full disclosure of material facts.

C. Defining Standards of Conduct.

Exoneration provisions are often based on standards of conduct: good faith, bad faith, reckless indifference, etc. It is important to be familiar with how courts will construe such terms when considering an action that could result in a claim of trustee liability.

1. Bad Faith.


2. Good Faith.

Texas recognizes a standard of good faith that is in part subjective and in part objective. See Lee v. Lee, 47 S.W.2d 767, 795 (Tex.App.—Houston [14th Dist.] 2001, pet. denied). A fiduciary acts in good faith when he or she: (1) subjectively believes his or her defense is viable, and (2) is reasonable in light of existing law. Id.


Gross negligence means more than momentary thoughtlessness, inadvertence, or error of judgment; it means such an entire want of care as to establish that the act or omission was the result of actual conscious indifference to the rights, safety, or welfare of the person affected. See Transp. Ins. Co. v. Moriel, 879 S.W.2d 10, 20 (Tex. 1994)). An act or omission that is merely thoughtless, careless, or not inordinately risky cannot be grossly negligent. Id. at 22. Only if the defendant’s act or omission is unjustifiable and likely to cause serious harm can it be grossly negligent. Id. Although gross negligence does refer to a different character of conduct than ordinary negligence, a party’s conduct cannot be grossly negligent without being negligent. See Trevino v. Lightening Laydown, Inc., 782 S.W.2d 946, 949 (Tex.App.—Austin 1990, writ denied). Gross negligence involves proof of two elements:

- Viewed objectively from the actor’s standpoint, the act or omission must involve an extreme degree of risk, considering the probability and magnitude of the potential harm to others. “Extreme risk” is not a remote possibility of injury or even a high probability of minor harm, but rather the likelihood of serious injury to the plaintiff; and,
- The actor must have actual, subjective awareness of the risk involved, but nevertheless proceed in conscious indifference to the rights, safety, or welfare of others. Ordinary negligence rises to the level of gross negligence when it can be shown that the defendant was aware of the danger but his acts or omissions demonstrated that he did not care to address it. See Louisiana-Pacific Corp. v. Andrade, 19 S.W.3d 245, 246-47 (Tex. 1999). See Mobil Oil Corp. v. Ellender, 968 S.W.2d 917, 921 (Tex. 1998) (citing Moriel, 879 S.W.2d at 23 (Tex. 1994).

D. Delegation of Duties.

A trustee, as a fiduciary, has equitable duties to hold and manage the property for the benefit of the beneficiaries.” Alpert v. Riley, 274 S.W.3d 277, 291 (Tex.App.—Houston [1st Dist.] 2008, no pet.) (citing Tex. Prop. Code Ann. §§ 113.051, 113.056(a) (Vernon 2007)). “Certain of those fiduciary duties are nondelegable.” Id. (citing Tex. Commerce Bank, N.A. v. Grizzle, 96 S.W.3d 240, 249 (Tex.2002); Slay v. Burnett
**IV. FUNDAMENTALS OF INTERPRETING TRUST DOCUMENTS**

**A. Overview**

The Texas Trust Code empowers the trustee of an express trust to perform various acts on behalf of the trust. See Tex. Prop. Code Ann. §§ 113.001 et seq. (Vernon 2007 & Supp. 2010). A trustee is generally vested with a wide measure of discretion in prudent operation of the trust. See Barrientos v. Nava, 94 S.W.3d 27 (Tex.App.—Houston [14th Dist.] 2002, no writ). And, “it is fundamental that a trustee has a duty to obey [a trust's payment] instructions, unless it is impossible or illegal for him to do so, or unless he is excused by the court.” Doherty v JPMorgan, 2010 WL 1053053 at *7 (citing G. Bogert, THE LAW OF TRUSTS AND TRUSTEES § 811 (2d ed.1979)).

The primary focus in interpreting the provisions of the trust is the intent of the settlor. See State v. Rubion, 308 S.W.2d 4 (Tex. 1957). Courts generally interpret a trust agreement as it would a contract. See Goldin v. Bartholow, 166 F.3d 710, 715 (5th Cir.1999). A court should first determine the intention of the settlor from the language used within the four corners of the document. See Hurley v. Moody Nat. Bank of Galveston, 98 S.W.3d 307, 310 (Tex. App.—Houston [1st Dist.] 2003, no pet.) (citing Reddahl v. Long, 417 S.W. 2d 387, 389 (Tex. 1967)); Myrick v. Moody, 802 S.W.2d 735, 738 (Tex.App.—Houston [14th Dist.] 1990, writ denied). And in doing so, courts construe the trust instrument to give effect to all provisions so that no provision is rendered meaningless. See Hurley, 98 S.W.3d at 310; Myrick, 802 S.W.2d at 738.

**B. Unambiguous Instrument**

When no ambiguity exists the meaning of a trust agreement is a question of law. Alpert v. Riley, 274 S.W.3d at 286 (citing Nowlin v. Frost Nat'l Bank, 908 S.W.2d 283, 286 (Tex.App.—Houston [1st Dist.] 1995, no writ)). The court may construe a document as a matter of law when it “can give a definite legal meaning or interpretation to an instrument's words: as it is unambiguous.” Id. (citing Coker v. Coker, 650 S.W.2d 391, 393 (Tex.1983)). And, when the trust instrument is unambiguous and expresses the intentions of the settlor, the instrument speaks for itself and it is not necessary to construe the document. See Keisling v. Landrum, 218 S.W.3d 737 (Tex.App.—Fort Worth 2007, pet. denied) citing Corpus Christi Nat'l Bank v. Gerdes, 551 S.W.2d 521, 523 (Tex.App.Civ.—Corpus Christi 1977, writ ref'd n.r.e); Eckels v. Davis, 111 S.W.3d 687, 694 (Tex.App.—Fort Worth 2003, pet.
denied); Wright v. Greenberg, 2 S.W.3d 666, 671 (Tex.App.—Houston [14th Dist.] 1999, pet. denied). An unambiguous instrument confers the trustee’s powers, and neither the court nor the trustee can add or take away such powers. See Id.; see also Beatty v. Bales, 677 S.W.2d at 754. The trust is entitled to that construction which the settlor intended. Beatty v. Bales, 677 S.W.2d at 754. In such circumstances, outside evidence should not be considered. Id.

C. Ambiguous Instrument

What if the language is not clear? When the intent of the settlor is not clear from the language of the instrument, the trustee should consider the value of the corpus of the trust, and the relations between the settlor and the beneficiaries, and all circumstances regarding the trust and beneficiaries at the time the trust was executed. See First National Bank of Beaumont v. Howard, 229 S.W.2d 781, 783 (Tex. 1950) (citing McCreary v. Robinson, 59 S.W. 536 (Tex. 1900)).

1. Actions During Lifetime

If the settlor provided for the beneficiary in a certain manner during his/her lifetime then that action is relevant in determining what the settlor intended to be provided from the trust. See Beaumont v. Howard, 229 S.W.2d at 783. In Beaumont, the settlor had been very generous toward both of his daughters during his life. Id at 785. The court found that the trustee lacked the same generous attitude in administering the trust and therefore was not “acting in that state of mind in which the settlor contemplated that it should act.” Id.

2. Other Trusts Created by Settlor

If the settlor created multiple trusts for the beneficiary, the terms of the other trusts may also provide evidence of the settlor’s intent. See Restatement (Third) of Trusts § 50 cmt e, illus. g(1) (2003) (significance of beneficiary’s other resources and illustrative situation).

3. Context of the Creation of the Trust

The circumstances that resulted in the creation of the trust may be relevant when determining a settlor’s intent. For example, a settlor may have desired to give all of his property outright to his/her spouse but, on advice of counsel, leaves the property to his/her spouse in trust. See Restatement (Third) of Trusts § 50 cmt e, illus. g(1) (2003).

4. Framing the Issue: Overall Intent vs. Specific Intent

The decision of Coffee v. William Marsh Rice University is frequently discussed in the context of overall versus specific intent. 408 S.W.2d 269 (Tex. 1966); see also discussion infra. In Coffee, the trust document provided that the university was for the use of “the white residents of Houston.” Id. at 272. The plaintiffs brought suit against the trustees of Rice in order to prevent them from admitting black students. The court acknowledged that the language of the trust was clear. The court reasoned, however, that the overall intent of the settlor was to create and maintain a university. And, conditions had significantly changed between the time when the trust was created and 1966 when the suit was brought. Therefore, the trustees, under the doctrine of cy pres, were free to disregard the particular provisions applicable to race in order to accomplish what the court found to be the overall intent of the settlor.

D. Common Terms

Common words should be given their plain meaning unless the context indicates the words were used in another sense. Patrick v. Patrick, 182 S.W.3d 433, 436 (Tex.App.—Austin 2005, no pet.); Tex. Govt’ Code Ann. § 312.002 (Vernon. 2005) (“Meaning of Words: (a) Except as provided by Subsection (b), words shall be given their ordinary meaning. (b) If a word is connected with and used with reference to a particular trade or subject matter or is used as a word of art, the word shall have the meaning given by experts in the particular trade, subject matter, or art.”).

1. Shall Versus May

Most practitioners understand the literal meaning of these two words: “shall” is mandatory and requires that distributions be made and “may” provides the trustee with discretion to make distributions. See Doherty v JPMorgan, 2010 WL 1053053 (Tex.App.—Hous. [1st Dist.] 2010) (no pet hist.); see also Tex. Gov’t Code Ann. § 311.016 (Vernon. 2005) (“The following constructions apply unless the context in which the word or phrase appears necessarily requires a different construction or unless a different construction is expressly provided by statute: (1) "May" creates discretionary authority or grants permission or a power. (2) "Shall" imposes a duty."); see also Roberts v. Clark, 188 S.W.3d 204, 210 (Tex.App.—Tyler 2002, pet. denied)(citing Black’s Law Dictionary 1379 (7th ed.1999)("shall" as used in contracts is generally mandatory, operating to impose duty); but see Penix v. First National Bank of Paris, 260 S.W.2d 63 (Tex.Civ.App.—Texarkana 1953, writ ref’d).

For example, in the recent decision of Doherty v JPMorgan, the court held that a trust distribution that provided that the trustee “shall also distribute to [Doherty] such amounts of trust principal as she may request to provide for her comfort, health, support or maintenance, in order to maintain her in accordance with the standard of living to which she was accustomed at the time of [her husband’s] death” was mandatory and not discretionary. See 2010 WL 1053053 at Pg. 4. Thus, the trustee was required to distribute funds requested for the beneficiary’s “comfort, health, support or maintenance.” See Id.
But, the court in *Penix* ruled that the trustee in the case was within his discretion to withhold a portion of the income generated by the trust despite the language of the trust that stated: “[income] shall be used for support, maintenance and schooling.” *Id* at 64 (emphasis added). The *Penix* decision, when viewed within the context of the entire body of case law, should not, however, be interpreted to stand for the proposition that “shall” and “may” are interchangeable terms. Rather it is one of many examples of the courts looking to the desired outcome and elevating “trustee discretion” or “intent of the settlor” over the plain language of the trust.

2. **Necessary Versus Appropriate**

Necessary provides a basis for the trustee to consider the beneficiary’s other resources when the trust is silent as to the consideration of other resources. *See First National Bank of Beaumont v. Howard*, 229 S.W.2d at 786. Appropriate provides the trustee with more discretion. But, the Restatement (Third) of Trusts, in discussing the intent of the settlor, states:

...the settlor may manifest an intention that other resources *are not* to be taken into account (as in an absolute gift of support) or that they *must* be (as in a provision for payments ‘only if and as needed’ to maintain an accustomed standard of living), with the trustee to have no discretion in the matter. (Contrast, however, the common phrase “necessary for support,” which without more normally does not limit the trustee’s discretion in this way.).

Restatement (Third) of Trusts § 50 cmt e (significance of beneficiary’s other resources); *see also Keisling v. Landrum*, 218 S.W.3d 737 (Tex.App.—Fort Worth 2007, pet. denied).

3. **Absolute or Uncontrolled Discretion**

Both case law and the Restatement provide that these terms are not to be interpreted literally. A trustee’s discretion is always subject to judicial review and control. *See State v. Rubion*, 308 S.W.2d at 9. A trustee continues to be required to act honestly and in a manner contemplated by the settlor. *See discussion supra*. The inclusion of these terms serves to discourage remaindermen from complaining if the distributions are generous.

The provision does not serve to cut completely the other way to allow the trustee to make no distributions. The Restatement discusses this lopsided interpretation stating: “The overall tenor of the terms of a power may, however, in the context of the trust’s more general purposes, lead to an interpretation granting the trustee ordinary discretion with respect to the benefits to which the discretionary beneficiary is minimally entitled (e.g. reasonable support), with the extended discretion applicable to the trustee’s allowance of more.” Restatement (Third) of Trusts § 50 cmt c (2003)(effect of extended discretion).

4. **Sole, Final or Conclusive Discretion**

Likewise, terms such as sole, final or conclusive do not vest an unlimited discretion in a trustee. *See Howard*, 229 S.W.2d at 783. In *Howard*, the court held that the “test to be applied is: When it makes payments to the beneficiaries out of the corpus of the estate is the trustee acting in that state of mind in which the settlor contemplated that it should act?” *Id*. (citing William F. Frathcer, *Scott on Trusts*, Vol. 2, Sec. 187, p. 987; *see also* 65 C.J., Trusts, Sec. 727, p. 847). When the settlor’s intention is not made clear by the terms of the trust, consideration is given to (i) value of the estate, (ii) the previous, relations between him and the beneficiaries, and (iii) all the circumstances in regard both to the estate and the parties existing when the will was made and when the settlor died. *Id*. (*citing McCreary v. Robinson*, 59 S.W. 536 (Tex. 1990); 101 A.L.R. p. 1462, Ann. II. a. 1). Consequently, even when a trustee’s discretion is declared to be final and conclusive, courts will interfere if the trustee acts outside the bounds of a reasonable judgment. *See Id.; but see Story v. Story*, 176 S.W.2d 925 (Tex. 1944); *Ballenger v. Ballenger*, 668 S.W.2d 467 (Tex.Civ.App—Corpus Christi 1984, writ dism’d)(trial court erred in granting temporary injunction that served to restrict trustees from exercising their “sole discretion” authority by substituting the judgment of the trial court for that of the named trustees).

V. DISTRIBUTION STANDARDS

A. **Mandatory Distributions**

A mandatory distribution standard is one that requires the distribution of income or principal, or both, in a manner that generally does not require the exercise of a trustee’s discretion. The most common mandatory distributions involve the distribution of all income. For example, for Qualified Terminable Interest Property held in trust, the trustee is required to distribution all income to a spouse at least annually in order to qualify for the marital deduction. *See I.R.C. 2056(b)(7)(surviving spouse must be “entitled to all the income from the property, payable annually or at more frequent intervals”).* A settlor can also provide for mandatory distributions of principal. For example, some trusts provide that the trust distribute a certain percentage of principal each year. A trust could also require that a certain percentage of principal be distributed to a beneficiary upon reaching a particular age or goal, such as graduating from college.

While a mandatory distribution standard may be required in certain situations, such as with a QTIP Trust, they should be used with caution. A mandatory distribution standard will generally result in the loss of...
the spendthrift protection as to the portion required to be distributed and may require distributions to persons who because of age or incapacity are unable to handle the funds. See discussion infra.

B. Discretionary Distributions

In contrast, discretionary distributions standards generally require the exercise of a trustee’s discretion. Discretionary distribution standards may be ascertainable or unascertainable. The selection of the distribution standards is often based on a number of factors including:

- Purpose of trust;
- Whether a beneficiary may serve as trustee;
- Preference between current and remainder beneficiaries; and
- Preference for objective versus subjective standard of review.

1. Ascertainable Standard

The most commonly used ascertainable standard for making trust distributions is “health, education, maintenance and support. See Treas. Reg. §20.2041-1(c)(2) (“A power to consume, invade, or appropriate income or corpus, or both, for the benefit of the decedent which is limited by an ascertainable standard relating to the health, education, support, or maintenance of the decedent is, by reason of section 2041(b)(1)(A), not a general power of appointment. A power is limited by such a standard if the extent of the holder’s duty to exercise and not to exercise the power is reasonably measurable in terms of his needs for health, education, or support (or any combination of them”); see also Treas. Reg. 1.674(b)-1(b)(5)(i) (“A clearly measurable standard under which the holder of a power is legally accountable is deemed a reasonably definite standard for this purpose. For instance, a power to distribute corpus for the education, support, maintenance, or health of the beneficiary; for his reasonable support and comfort; or to enable him to maintain his accustomed standard of living; or to meet an emergency, would be limited by a reasonably definite standard.”). This is commonly referred to as a HEMS standard.

Treas. Reg. § 20.2041-1(c)(2) provides the following examples of powers limited by an ascertainable standard:

- Support;
- Support in reasonable comfort;
- Maintenance in health and reasonable comfort;
- Support in his accustomed manner of living;
- Education, including college and professional education;
- Health; and,

- Medical, dental, hospital and nursing expenses and expenses of invalidism.'

See Treas. Reg. §20.2041-1(c)(2).

An ascertainable or HEMS standard is often used when the settlor desires to include more objective distribution standard. It is also used when the settlor is concerned about maintaining the trust principal for the reminder beneficiaries. Above all, its prevalence among drafters is driven by tax considerations.

a. Tax Planning Considerations

A HEMS standard is particularly important to avoid unintended tax consequences. This standard is considered to be an “ascertainable” standard under the Internal Revenue Code and, thus, provides a permissible distribution standard that avoids granting the trustee a general power of appointment, along with the tax consequences of holding that power. See Id. Even documents that name an independent trustee frequently use this standard to allow the possible future appointment of the settlor, settlor’s spouse, beneficiary or other sensitive person as trustee without undesirable tax consequences.

While a complete discussion of the HEMS standard is beyond the scope of this outline, the following provides an overview of some of the more common planning situations in which the use of an ascertainable standard is important.

(i). Beneficiary as Trustee - Distributions to Self - Avoid Estate Tax Inclusion and Avoid Gift on Lapse

If a beneficiary of a trust holds a power, as trustee or otherwise, to make distributions to himself or for his benefit, and the power is limited by an ascertainable standard relating to the beneficiary’s health, education, support, or maintenance, then the trust property will not be included in the gross estate of the beneficiary for federal estate tax purposes by reason of the beneficiary’s possession of such power, because such a limited power does not constitute a “general power of appointment.” I.R.C. §2041(b)(1)(A); Treas. Reg. §20.2041-1(c)(2). Also, the lapse or other release or exercise of such a power limited by such an ascertainable standard will not be a taxable gift for federal gift tax purposes by the beneficiary which held the power. I.R.C. §2514(c)(1); Treas. Reg. §25.2514-1(c)(2).

(ii). Beneficiary as Trustee – Avoids Loss of Spendthrift Protection

If a beneficiary of a trust, as trustee or otherwise, holds a power to make distributions to himself or for his benefit, an issue can arise regarding the ability of the beneficiary’s creditors to satisfy claims against the beneficiary from the beneficiary’s interest in the trust. When, however, the trust has a spendthrift provision and the beneficiary’s power is limited by an
ascertainable standard relating to the beneficiary’s health, education, support, and/or maintenance, a creditor generally cannot attach the beneficiary’s interest on the basis that the beneficiary holds a distribution right or power. Tex. Prop. Code Ann. § 112.035 (Vernon 1995 & Supp. 2010). But, to create a statutory “fix” for this issue, effective September 1, 2009, Section 113.029 was enacted to. Section 113.029(b):

(b) Subject to Subsection (d), and unless the terms of the trust expressly indicate that a requirement provided by this subsection does not apply:

(1) a person, other than a settlor, who is a beneficiary and trustee of a trust that confers on the trustee a power to make discretionary distributions to or for the trustee's personal benefit may exercise the power only in accordance with an ascertainable standard relating to the trustee's individual health, education, support, or maintenance within the meaning of Section 2041(b)(1)(A) or 2514(c)(1), Internal Revenue Code of 1986; and

(2) a trustee may not exercise a power to make discretionary distributions to satisfy a legal obligation of support that the trustee personally owes another person.


Note, however, that Section 113.029(b) “does not apply to: (1) a power held by the settlor's spouse who is the trustee of a trust for which a marital deduction, as defined by Section 2056(b)(5) or 2523(e), Internal Revenue Code of 1986, was previously allowed; (2) any trust during any period that the trust may be revoked or amended by its settlor; or (3) a trust if the settlor is the trustee or controls the trustee of a trust, if limited by an ascertainable standard relating to the beneficiary’s health, education, support, or maintenance, will not cause the trust property to be included in the gross estate of the settlor/trustee for federal estate tax purposes under I.R.C. Sections 2036 or 2038. Estate of Budd, 49 T.C. 468 (1968) acq. 1973-2 C.B. 1; Estate of Frew, 8 T.C. 1240 (1947); Rev. Rul. 73-143, 1973-1 C.B. 407; PLRs 200213013, 200123034, 200011055, 200011054, 199903025, 9527025.

(v) Settlor or Settlor’s Spouse as Trustee - Income tax relevance

The power of any trustee, including the settlor, to distribute corpus to or for a beneficiary or beneficiaries, limited by a “reasonably definite standard” set forth in the trust instrument, will not cause the trust income to be taxed to the settlor for federal income tax purposes. I.R.C. § 674(b)(5)(A). A “reasonably definite standard” includes “a power to distribute corpus for the education, support, maintenance, or health of the beneficiary.” Treas. Reg. § 1.674(b)-1(b)(5)(i). Yet, a reasonably definite standard which limits the power to distribute income to or for a beneficiary or beneficiaries, is not sufficient to prevent the trust income from being taxed to the settlor, if the settlor or settlor’s spouse is one of the trustees holding the power to distribute income. I.R.C. § 674(b), (d).

b. “Support” and “Maintenance”

The terms support and maintenance are generally considered to be similar. In fact, under the Restatement
When the distribution standard includes the terms support or maintenance, a trustee’s discretion is not unbridled discretion. See Id. (citing First National Bank of Beaumont v. Howard, 229 S.W.2d 781, 785 (Tex. 1950); Anderson v. Menefee, 174 S.W. 904 (Tex.Civ.App.—Fort Worth, writ refused, writ ref’d); William F. Frathcer, Scott on Trusts, Vol. 2, § 187, p. 986). Rather, the trustee’s discretion must be “reasonably exercised to accomplish the purposes of the trust according to the settlor’s intention and his exercise thereof is subject to judicial review and control”. Id. (citing William F. Frathcer, Scott on Trusts, §§ 187, 187.1, 187.2, and 187.3; Kelly v. Womack, 268 S.W.2d 903, 907 (Tex. 1954); Powell v. Parks, 86 S.W.2d 725 (Tex. 1935); Davis v. Davis, 44 S.W.2d 447 (Tex.Civ.App.—Texarkana 1931, no writ)).

The Texas Supreme Court in Rubion recognized a number of factors that should be considered by a trustee exercising its discretion in a “support” or “maintenance” trust. Rubion, 308 S.W.2d at 10. They include:

- The size of the trust estate;
- The beneficiary’s age, life expectancy, and condition in life;
- The beneficiary’s present and future needs;
- The other resources available to the beneficiary’s individual wealth; and,
- The beneficiary’s present and future health, both mental and physical.

Id. at 10-11; see also In re Gruber’s Will, 122 N.Y.S.2d 654, 657 (N.Y. Sur. 1953)(age and condition of beneficiary, amount of trust fund, and other factors); Hanford v. Clancy, 183 A. 271, 272 (N.H. 1936)(size of fund, present situation of beneficiary, present and future needs, other resources, and future emergencies); Falsey’s Estate, Sur., 56 N.Y.S.2d 556, 563 (N.Y. Sur. 1945) (age of beneficiary, physical and mental health of beneficiary, size of trust compared to beneficiary’s life expectancy).

There are common factors in all of these cases and the most relevant factors when a trustee is exercising its discretion are discussed below.

(i). Bare Necessities

Support means more than the bare necessities of life. Hartford-Connecticut Trust Co. v. Eaton, 36 F.2d 710 (2d Cir. 1929). Rather, it generally includes the beneficiary’s ordinary living expenses. Ordinary living expenses may include “regular mortgage payments, property taxes, suitable health insurance or care, existing programs of life and property insurance and continuation of accustomed patterns of vacation and charitable and family giving.” Restatement (Third) of Trusts § 50 cmt d (2003).

(ii). Educational Expenses

Support has also been held to include the educational expenses of the beneficiary’s dependants. See First National Bank of Beaumont v. Howard, 229 S.W.2d 781 (Tex. 1950). In First National Bank of Beaumont, the Texas Supreme Court held that the fact that the settlor had paid for his daughters’ college education indicated that he considered the expense of a college education as a “necessary” expenditure. Id.; see also discussion of actions during lifetime supra.

(iii). Implied Standard of Living

The standard of living of the beneficiary is usually determined as of the time of the settlor’s death or when the trust became irrevocable. The implication that support is to be interpreted at that time is in keeping with interpreting the trust according to the settlor’s intent.

(iv). Trust Size

The interpretation of the terms of the trust requires a constant balancing of all relevant factors. The Restatement provides that the standard may be increased if either; (1) the beneficiary’s standard of living has increased, the increase is consistent with the trust’s productivity and the increase is not inconsistent with the productivity of the trust estate; or (2) considering the productivity of the trust failure to increase the beneficiary’s standard of living results in favoring the remainder beneficiaries over the current beneficiaries.

(v). Present Versus Future Needs

The needs of the beneficiary both present and future are to be considered by the trustee. But when the trust is potentially insufficient to provide for both needs, the trustee is faced with a difficult decision. Unfortunately, the few courts that have addressed this issue have not held consistently. For example, compare the decision of State v. Rubion, 308 S.W.2d at 4, with Penix v. First National Bank of Paris, 260 S.W.2d 63 (Tex. Civ. App. – Texarkana, writ ref’d).

In Rubion, the Texas Supreme Court ruled that the trustee had abused his discretion by refusing to invade the principal of the trust to make payments for the beneficiary’s care while she was in a state mental hospital. Rubion, 308 S.W.2d at 8. The trustee argued that he was within his discretion to withhold payments of principal because the corpus of the trust should be preserved for her support if she were ever discharged from the hospital, and further, that if the trust corpus were used to pay all of her medical care it would completely destroy the trust. Id. Disagreeing, the court
held the trustee abused his discretion by withholding the entire principal and the trustee should have determined what amount could have been distributed while still preserving the long-term health of the trust. *Id.* at 9.

In *Penix*, the appellate court ruled that a trustee was within its discretion to withhold principal as well as income in the present, in order to meet the future needs of the beneficiary. *See Penix*, 260 S.W.2d at 67. The trustee argued successfully that the beneficiary was a 9-year old girl, that the income produced from the trust was well in excess of what was needed for her current support etc., and that any excess above the beneficiary’s current needs should be held in reserve for emergencies. *Id* at 64-65. The court found that the trustee was within its discretion, relying heavily on the language granting the trustee the power to carry out the terms of the trust “free from any supervision by the probate or other courts.” The court discounted any significance of the word “shall” within the grant. *Id.*

While *Penix* and *Rubion* appear to conflict with each other, they consistently adhere to the same rule. When exercising discretion in a support trust, a trustee should consider both the present and future needs of the beneficiary.

c. Education

Without limiting or expanding provisions, education is considered to include living expenses, tuition, fees, books and other cost of higher education and/or technical training. *See Restatement (Third) of Trusts § 50 cmt d(3) (2003).*

d. Health

The term health typically includes distributions for health as would be implied from a support standard alone. *See Restatement (Third) of Trusts § 50 cmt d(3) (2003).*

2. Unascertainable Standards

While an ascertainable standard is commonly used, it is not mandatory. A settlor can simple provide that distributions can be made in the trustee’s sole discretion. Alternatively, the settlor can use other standards on which distributions can be made. These are generally considered to be unascertainable as there is no objective manner by which to determine whether a distribution (requested or made) fits within the distribution standard of the instrument.

Unascertainable standards may be used when the settlor is less concerned about maintaining the trust principal for the remainder beneficiaries or when he or she wants the trustee to have more flexibility in making distributions. Due to the potential tax implications, these standards should be used with caution and only with an independent trustee. As discussed previously, when a beneficiary serves as trustee or possess certain powers relating to the trust, the use of an unascertainable standard can create tax and creditor issues.

While there is no clear definition of what terms will result in an unascertainable distribution standard, the following terms have been defined to create one:

- Comfort;
- Happiness;
- Benefit; and
- Welfare.

*See Treas. Reg. §20.2041-1(c)(2)(“A power to use property for the comfort, welfare, or happiness of the holder of the power is not limited by the requisite standard.”); see also Treas. Reg. 1.674(b)-1(b)(5)(ii)(a power to distribute corpus for pleasure, desire, or happiness of beneficiary is not limited by a reasonably definite standard).*

a. Comfort

A distribution standard that includes comfort as a basis has generally been held to create an unascertainable standard. Treas. Reg. §20.2041-1(c)(2); *First Virginia Bank v. United States*, 490 F.2d 532 (4th Cir. 1974)(“In the absence of [state] law limiting [beneficiary’s] power to distribute corpus for pleasure, desire, or happiness of the holder of the power is not limited by the requisite standard”); but see *Estate of Strauss*, T.C. Memo 1995-248 (court held under Illinois law, "comfort" is ascertainable standard); *Pyle v. United States*, 766 F.2d 1141 (7th Cir. 1985)(government argued comfort ascertainable under state law); *Rock Island Bank & Trust Co. v. Rhoads*, 187 N.E. 139 (Ill. 1933)(comfort ascertainable under Illinois law as it refers to maintaining someone in station of life to which that person is accustomed and because station in life is known, standard is measurable and hence ascertainable.)

In Texas, comfort is not limited by state law in a manner that would allow it to be considered an ascertainable standard. *See Lehman v. United States*, 448 F.2d 1318, (5th Cir. 1971). In *Lehman*, the court considered a Texas will that provided that the wife “in the exercise of her own discretion, . . . consume for her own use, benefit, comfort, support, and maintenance, all or any part of the corpus of my estate or proceeds thereof whenever she, in her own discretion, deems the income, rents, and revenues thereof insufficient for her support, maintenance, comfort, and welfare.” *Id.* The Fifth Circuit noted that “the critical fact is that, regardless of the name attached to it, her interest was
obviously coupled with plenary authority to convey, encumber or consume the property, and Texas courts have consistently accorded full force and effect to similar testamentary provisions.” Id (citing Messer v. Johnson, 422 S.W. 2d 908, 912 (Tex. 1968); Commercial Bank, Unincorporated of Mason v. Satterwhite, 413 S.W. 2d 905, 909 (Tex. 1967); Murphy v. Slaton, 273 S.W. 2d 588 (Tex. 1954); Nye v. Bradford, 193 S.W. 2d 165, 167 (Tex. 1946), Edds v. Mitchell, 184 S.W. 2d 823, 825 (Texas 1945); McMurray v. Stanley, 6 S.W. 412, 415 (Tex. 1887)). Therefore, based on Texas law, the court held the inclusion of the word comfort resulted in the wife possessing an “unrestricted and discretionary right – at least in the absence of evidence of actual fraud – to consume the property, governed only by her own personal assessment of her own personal need.” See Id.

The Restatement also provides that it is consistently interpreted as broadening the standard and indicating that the trustee exercise its discretion more generously. See Restatement (Third) of Trusts § 50 cmt d(3) (2003)(other standards and supplementary language).

b. Happiness

The word happiness has been found to create an unascertainable standard. Treas. Reg. §20.2041-1(c)(2). The Restatement provides that it is consistently interpreted as broadening the standard and indicating that the trustee exercise its discretion more generously. See Restatement (Third) of Trusts § 50 cmt d(3) (2003)(other standards and supplementary language).

c. Welfare

A distribution standard that includes welfare has also been found to create an unascertainable standard. See Treas. Reg. §20.2041-1(c)(2); First Virginia Bank v. United States, 490 F.2d 532 (4th Cir. 1974)(“In the absence of [state] law limiting [beneficiary’s] power to consume the proceeds from the sale of the stock to an ascertainable standard relating to her health, support, or maintenance, the value of the stock must be included in her gross estate. While the power to consume need not be limited to the bare necessities of life, the Regulations specifically state: "A power to use property for the comfort, welfare, or happiness of the holder of the power is not limited by the requisite standard"). Likewise, the Restatement provides that it is consistently interpreted as broadening the standard and indicating that the trustee exercise its discretion more generously. See Restatement (Third) of Trusts § 50 cmt d(3) (2003)(other standards and supplementary language).

d. Benefit

Similarly, the inclusion of the word benefit in a distribution standard has been found to create an unascertainable standard. See Id. The Restatement provides that it is consistently interpreted as broadening the standard and indicating that the trustee exercise its discretion more generously. See Restatement (Third) of Trusts § 50 cmt d(3) (2003)(other standards and supplementary language).

C. Drafting Suggestions

Distributions standards should be carefully drafted to avoid ambiguity, clarify preferences as between beneficiaries, and provide clear guidance to the fiduciary in making distributions. The ability to do so often depends of the type of gifts and the related tax issues.

1. Marital Gifts.

Marital gifts in trust often create issues due to the need to qualify for the unlimited marital deduction. As previously discussed, to qualified as a QTIP, a trust must meet certain requirements including the distribution of all income. This may lead to conflicts between the distribution requirement of the spouse and the responsibilities to the remainder beneficiaries. Options to reduce conflicts may include:

- Express language regarding the ability to exhaust the trust in supporting the surviving spouse;
- State preferences as between the spouse and remainder beneficiaries;
- Allowing a trustee to make the discretionary principal distributions to spouse using an ascertainable or non-ascertainable standard;
- Including a unitrust or return trust standard;
- Clarifying whether a trustee must take into account other resources when making distributions of principal;
- Define other resources: i.e., liquid versus illiquid assets and income versus principal;
- Clarifying whether any applicable lifestyle standard is as of the client’s death or at the applicable time;
- A spouse’s rights of withdrawal;
- Selecting non-beneficiary or independent trustees;
- Trust protectors; and
- Giving a spouse a power of appointment.


Similar to marital trust, it is advisable to include provisions that reduce conflicts between various beneficiaries. Options to reduce conflicts may include:

- Clarifying a trustee’s degree of discretion (i.e., may versus shall);
• State preferences as between the various beneficiaries;
• Allowing the trustee the ability to make discretionary income and principal distributions using an ascertainable or non-ascertainable standard;
• Clarifying whether a trustee must take into account other resources when making distributions of income and principal;
• Define other resources: i.e., liquid versus illiquid assets and income versus principal;
• Clarifying whether any applicable lifestyle standard is as of the client’s death or at the applicable time;
• Clarifying any preference as between the various basis for distributions – i.e., if education is the primary reason, indicate so;
• Educational incentives and objectives;
• Clarifying a trustee’s ability to treat distributions as advancements;
• Distributions in satisfaction of a beneficiary’s duty of support;
• Distributions during periods of minority, incapacity, commitment, divorce, or other conditions;
• Methods of payment;
• Trust protectors; and
• Powers of appointment.

3. All Trusts.
When the settlor provides additional guidance by including specific language, the settlor may intend to broaden the trustee’s discretion. In reality, the settlor may actually limit the trustee’s discretion and therefore the distributions that can be made. The more specific the trust provisions, the more likely it is that the trust document will be considered unambiguous and extrinsic evidence will not be allowed. To avoid either limiting the scope and flexibility of the document, the settlor can include a “Purpose Clause” in the document that can provide both guidance and flexibility. See discussion infra.

4. Purposes Clauses.
In the past, a client would periodically write a letter to his or her beneficiaries setting out his or her intentions as it relates to the trust. The inherent problem with these expressions of intent is that often they could provide no real guidance to the trustee as the trustee is limited to the four corners of the trust instrument.

But, these statements often provide a psychological benefit to both trustees and beneficiaries as they offer a personal message to the beneficiaries. As a result, some drafters are including purpose statements in the terms of the trust. This avoids the issue of whether the statement is enforceable or can provide any real guidance. But, care needs to be taken not to create an ambiguity in the terms of the trust or place unintended restrictions a trustee’s discretion. Sample purpose statements are attached as Exhibit A and B.

While many clients like the idea of a purpose statement, they may not fully understand them or how to drafting one. An excerpt from Marjorie Stephen’s client guidebook explaining these purposes statements is attached as Exhibit C.

VI. POTENTIAL LIMITATIONS ON DISTRIBUTION STANDARDS
A. Standard of Living - Station in Life
As discussed above, even without the inclusion of these terms, a distribution for support is to be made according to the beneficiary’s station in life.

B. Other Resources
When making discretionary distributions, a trustee should consider whether he or she is obligated to consider the beneficiary’s other resources. If the settlor has provided guidance in this area, the settlor’s intent will control. Also, as is reflected in the discussion below, all rules are tempered by the settlor’s intent as reflected in the overall purpose of the trust.

1. General Rule
If the trust document is silent, a trustee should generally consider other resources but has some discretion in determining the impact of the resources on the distributions to be made from the trust. The consideration of other resources, however, is a balancing of the intent of the settlor regarding the treatment of the beneficiary and the other purposes of the trust and, these considerations may change the general rule. See Restatement (Third) of Trusts § 50 cmt e, (significance of beneficiary’s other resources).

2. Restatement Exceptions
The Restatements provide two exceptions to the general rule.

a. Other Trusts Created By Same Settlor
When the settlor has created other trusts of which the beneficiary receives distributions, then the trustee is to take into account the other distributions in making discretionary payments. See Id.

b. Beneficiary Not Intended to Be Self Supporting
When the beneficiary is in a situation in which he or she is not intended to be self-supporting (such as enrolled full-time in school), then the beneficiary’s other resources are generally not considered. See Id.

3. What Other Resources?
Other resources normally include the beneficiary’s other income but not principal available to the
beneficiary. See Keisling v. Landrum, 218 S.W.3d 737(Tex.App.—Fort Worth 2007, pet. denied). In the Keisling decision, the appellate court held that a beneficiary was not required to exhaust all her assets, other than a house and car, in order to receive distributions from a trust that provided the trustee shall distribute trust income when the beneficiary’s “own income and other financial resources from sources other than this trust are not sufficient” to maintain her standard of living. See Id. at 740. In reaching its decision, the appellate court found that “other financial resources” is limited to “income and other periodic receipts, such as pension and other annuity payments and court-ordered support payments.” Id. at 743 citing Restatement (Third) of Trusts § 50 cmt e(2) (significance of beneficiary’s other resources).

Depending on the terms and purpose of the trust, the principal of the beneficiary may be relevant. Once again, the determination of what resources to consider includes (i) the settlor’s relationships both to the current beneficiary and the remainder beneficiaries, (ii) the liquidity of the beneficiary’s assets and (iii) the purposes of the trust both tax and non-tax. See Restatement (Third) of Trusts § 50 cmt e(2) (what other resources are to be considered).

4. Affect on Ascertainable Standard

In determining whether a power is limited by an ascertainable standard, it is immaterial whether the beneficiary is required to exhaust his other income before the power can be exercised. See Treas. Reg. §20.2041-1(c)(2).

C. Priority of Beneficiaries

A trustee should consider whether he or she is obligated to give preference to one or more beneficiaries prior to making a discretionary distribution.

1. Settlor’s Intent Controls

The settlor may express a specific intent to favor a beneficiary or class of beneficiaries over another. If so, the settlor’s intent will control. Some trusts will do so by expressly providing that it is the settlor’s intent to provide for a certain beneficiary even to the extent of exhausting the trust. Other trusts will implicitly favor a beneficiary or a class of beneficiaries. For example, language that authorizes the distribution of principal, without regard to preservation of principal for the remaindermen, clearly expresses the intent of the settlor that the current beneficiary or beneficiaries are to be favored. See discussion infra.

2. Guidelines Under Texas Trust Code When No Expression of Intent

The Texas Trust Code provides that a trustee must act impartially when the trustee does not provide preference or priority as between the beneficiaries. Specifically, Section 116.004(b) provides as follows:

In exercising the power to adjust under Section 116.005(a) or a discretionary power of administration regarding a matter within the scope of this chapter, whether granted by the terms of a trust, a will, or this chapter, a fiduciary shall administer a trust or estate impartially, based on what is fair and reasonable to all of the beneficiaries, except to the extent that the terms of the trust or the will clearly manifest an intention that the fiduciary shall or may favor one or more of the beneficiaries. A determination in accordance with this chapter is presumed to be fair and reasonable to all of the beneficiaries.


Furthermore, Section 117.006 provides as follows:

If a trust has two or more beneficiaries, the trustee shall act impartially in investing and managing the trust assets, taking into account any differing interests of the beneficiaries.


3. Guidelines Under Restatement When No Expression of Intent

If there is no stated priority, the Restatement (Third) of Trusts suggests several inferences and constructional preferences as starting points. They include:

- Relationship to the settlor is relevant, leading in the most common situations to an inference that the beneficiary at the top of a line of descendants is favored over his or her own issue, with the settlor’s spouse also so favored whether or not an ancestor of the others (e.g. settlor’s issue by prior marriage).

- Among multiple lines of descent (e.g., all of the settlor’s issue) there is an inference of priorities per stirpes, that is, that (i) the various lines are entitled to similar, impartial (... but not necessarily equal) treatment, with disparities to be justified on a principled basis consistent with the trust purposes, and that (ii) the inference of favored status within a descending line begins with the person(s) at the top (e.g. the settlor’s child or the children of a deceased child).

See Restatement (Third) of Trusts § 50 cmt. f (multiple beneficiaries or groups as concurrent discretionary distributes).
D. Parents Obligation To Support Beneficiary

Under Texas law, a parent has a legal obligation to support his or her minor children. The Texas Family Code provides that such a duty of support includes the duty to provide a child with clothing, food, shelter, and medical and dental care. See Tex. Fam. Code Ann. § 151.001 (Vernon 2002 & Supp. 2010) see also Daniels v. Allen, 811 S.W.2d 278 (Tex.Civ.App.—Tyler 1991, no writ)(parent has obligation to support his minor children and provide necessities). A parent’s obligation of support exists without the need for a court order. See In Interest of A.D.E., 880 S.W.2d 241 (Tex.Civ.App.—Corpus Christi 1994, no writ)(father has duty to support child, even when not ordered by trial court to make payments of support); Boriack v. Boriack, 541 S.W.2d 237 (Tex.Civ.App—Corpus Christi 1976, dism’d)(mother, as well as a father, has duty to support her minor children).

This duty of support must be considered when making distributions from a trust. See Gray v. Bush, 430 S.W.2d 258 (Tex.Civ.App.—Fort Worth 1968, ref. n.r.e.)(in absence of financial necessity to do so, mother was not authorized to invade funds provided by trust that was separate estate of children and was created for purpose of prescribed support payments). Unfortunately, no Texas decision has provided clear guidance as to the extent to which a trustee must consider a parent’s obligation of support. But, the decision of Deweese v. Crawford provides some guidance in this area. 520 S.W.2d 522 (Tex.App.—Houston [14th Dist.] 1975, writ ref’d n.r.e). In Deweese, the court considered a demand by the parents of minor children on a third party to distribute social security benefits the third party was receiving as “trustee” for the minor children. The court noted that the parents are principally responsible for the minor children’s support and maintenance. Therefore, only when it was shown that the parents were unable to meet their obligation to properly support and maintain the children was the trustee required to distribute funds for their benefit. Until the parents established they were unable to provide the requisite support, the court held that the trustee could appropriately choose to accumulate the benefits.

In reaching its decision, the Deweese court noted that issues regarding distributions of social security benefits are governed by federal law. Therefore, while it is not certain that the court’s decision would have been the same if the case involved a traditional trust instead of a trust created to administer federal benefits, the analysis and results should be the same. Furthermore, the decision in Deweese is consistent with Texas courts historical hesitancy to interfere with the reasonable exercise of a trustee’s discretion.

E. Beneficiary’s Obligation To Support Family Members

Beneficiaries will often seek or use distributions to support their family. This raises the issue of whether a trustee may take into account the needs of a beneficiary’s family, or his obligation of support when making distributions. Again, the intent of the settlor is paramount.

For example, in Cutrer, the guardian of the estate of a minor attempted to enforce a claim to an undivided interest in the corpus of three trusts. See Cutrer v. Cutrer, 345 S.W. 2d 513, 518-19 (Tex. 1961). Construing the terms of the trusts, the court held it was clear that the trust did not contemplate the adopted child as a potential contingent beneficiary. Id. at 517-18. Clearly the Cutrer court saw no need to stretch the class of beneficiaries using unrelated “family” definitions, but instead focused on the intent of the settlor and the terms of the trust.

Regardless of the settlor’s intent, a trustee of a support or discretionary trust may be required to make distributions for support of a beneficiary’s child when the beneficiary has been ordered to make child support payments. The extent of the payments depends on the type of trust: support versus discretionary.

A trustee of a support trust may be required to make distributions for the support of the beneficiary’s child. See Tex. Fam. Code Ann. § 154.005 (Vernon 2002) (“The court may order the trustees of a spendthrift or other trust to make disbursements for the support of a child to the extent the trustees are required to make payments to a beneficiary who is required to make child support payments as provided by this chapter.”). A trustee of a pure discretionary may only be ordered to make payments for the benefit of the child from income but not principal. See Id. (“If disbursement of the assets of the trust is discretionary, the court may order child support payments from the income of the trust but not from the principal.”).

A condition precedent to such an obligation is that the beneficiary has been ordered to pay child support. See Kolpack v. Torres, 829 S.W.2d 913 (Tex.Civ.App—Corpus Christi 1992, writ denied); see also Matter of Marriage of Long, 542 S.W.2d 712 (Tex.Civ.App.—Texarkana 1976, no writ)(trial court, instead of ordering trustees to pay to wife a certain sum per month for benefit of child, should have first ordered trust beneficiary parent to make child support payment or payments, after which it could have then ordered trustees to make disbursements for support of child.). In Kolpack, the appellate court held that a trial court could not obligate a trustee of a discretionary trust to...
make disbursement of trust income directly to a beneficiary’s child until it first imposed that obligation on the beneficiary/parent. \textit{Id.} at 916.

\textbf{F. Other Relevant Factors}

The Restatement (Third) of Trusts lists other factors that courts have considered when construing trust distribution standards. These include:

- Whether the remainder beneficiaries were to take “the principal” or “whatever principal remains”;
- The relationship between the settlor and one or more of the beneficiaries including not only family relationships but the personal feelings about a beneficiary, and occasionally about the beneficiary’s spouse;
- Whether the beneficiary is also a trustee;
- Whether the settlor made other provisions for the beneficiary;
- Whether the settlor was aware of the beneficiary’s other resources or of other circumstances; and,
- Whether a spendthrift restraint was imposed on the beneficiary.

The Restatement provided that these words can be given more significance than the realities of drafting warrant. The Third Restatement states that viewing the document as a whole, the purpose of creating the trust and the role of the discretionary power is more instructive than any individual words. \textit{See} Restatement (Third) of Trusts § 50 cmt g (general observations on relevant factors in the interpretation of discretionary powers).

\textbf{VII. POWER TO ADJUST INCOME AND PRINCIPAL}

The enactment of Texas’ version of the Uniform Principal and Income Act in 2004 made significant changes to the default rules relating to the allocation of trust receipts and disbursements as between principal and income. While a discussion of all provisions of the Uniform Principal and Income Act is beyond the scope of this outline, its provisions can have a profound impact on a trustee’s distribution of principal and income. Specifically, effective January 1, 2004, a trustee now has the ability to make adjustments between income and principal. A trustee also has the right to seek judicial guidance as to proposed adjustments, and a beneficiary has the right to seek judicial review of the adjustments. \textit{See} discussion \textit{infra}.

\textbf{A. Overview}

The new Principal and Income Act allows a trustee to make adjustments in the characterization of trust assets to increase or decrease assets that would have been more rigidly characterized as income or principal. This balances the requirement for a trustee to invest for total return under the prudent investor rule and the need to balance the interests of the income and principal/remainder beneficiaries. The ability to make adjustments is particularly significant when a trustee’s distribution powers are limited to income only for a particular beneficiary or beneficiaries. When a trustee, for example, invests the trust assets for total return by selecting growth stocks that provide insignificant “traditional” trust income; Section 116.005 allows the trustee to adjust the trust assets in a manner that the income beneficiary will receive a “reasonable” rate of return. What will be considered reasonable will be the question for the trustee and potentially the ultimate trier of fact if a dispute arises.

Note, that while other states adopted statutes permitting existing trusts to be converted to unitrusts, Texas did not. But, Texas Trust Code Section 116.007 confirms a settlor may define trust income in terms of unitrust percentages. Subject to any federal requirements, this could allow a marital deduction trust to be drafted as a unitrust (rather than a traditional income and principal trust) and still meet the required mandatory income distributions provisions of I.R.C. Section 2056. The Principal and Income Act applies to both existing trusts and trusts established after January 1, 2004. With regard to the administration of existing trusts, a trustee’s actions taken on or after January 1, 2004, will be determined by the new act, if applicable (i.e. the trust does not override such provisions). The old law will apply to all actions taken prior to January 1, 2004. As a general rule, and subject to a few exceptions, the Texas Trust Code applies unless the trust instrument provides otherwise.

Also, the Principal and Income Act generally imposes default rules. These new provisions may be overridden by clear directions to the contrary in the trust agreement. With regard to existing trusts, a preemption argument will be difficult. For example, the new adjustment provisions provide that trust provisions relating to adjustments of principal and income do not affect the new adjustment powers unless the terms “are intended to deny the trustee the power of adjustment conferred by Subsection (a).” \textit{Tex. Prop. Code Ann.} § 116.005(f) (Vernon Supp. 2010).

\textbf{B. Adjustments Between Principal and Income}

Texas Trust Code Section 116.005 permits a trustee to make adjustments between principal and income in certain situations. Section 116.005 provides that a trustee may make adjustments between principal and income to the extent:

- The trustee considers the adjustment \textit{necessary};
- The trustee invests and manages trust assets as a prudent investor;
The terms of the trust describe the amount that may or must be distributed to a beneficiary by referring to the trust's income; and

The trustee determines, after applying the rules in Section 116.004(a)(relating to a trustee’s fiduciary duties), that the trustee is unable to comply with Section 116.004(b)(i.e., impartiality except as modified by trust).


1. Adjustment Factors

In determining whether and to what extent to exercise the adjustment power, a trustee is required to consider all factors relevant to the trust and its beneficiaries; including the following statutory factors to the extent they are applicable:

- The nature, purpose, and expected duration of the trust;
- The intent of the settlor;
- The identity and circumstances of the beneficiaries;
- The needs for liquidity, regularity of income, and preservation and appreciation of capital;
- The assets held in the trust including, the extent to which they consist of financial assets, interests in closely held enterprises, tangible and intangible personal property, or real property, the extent to which an asset is used by a beneficiary, and whether an asset was purchased by the trustee or received from the settlor;
- The net amount allocated to income under the other sections of the new Principal and Income Act and the increase or decrease in the value of the principal assets, which the trustee may estimate as to assets for which market values are not readily available;
- Whether and to what extent the terms of the trust give the trustee the power to invade principal or accumulate income or prohibit the trustee from invading principal or accumulating income, and the extent to which the trustee has exercised a power from time to time to invade principal or accumulate income;
- The actual and anticipated effect of economic conditions on principal and income and effects of inflation and deflation; and
- The anticipated tax consequences of an adjustment.


2. Adjustment Limitations

The new Act also provides limitations on the power to adjust. These limitations are generally imposed to prevent the loss of certain tax opportunities. Specifically, a trustee may not make an adjustment that:

- Diminishes the income interest in a trust that requires all of the income to be paid at least annually to a spouse and for which an estate tax or gift tax marital deduction would be allowed, in whole or in part, if the trustee did not have the power to make the adjustment;
- Reduces the actuarial value of the income interest in a trust to which a person transfers property with the intent to qualify for a gift tax exclusion;
- Changes the amount payable to a beneficiary as a fixed annuity or a fixed fraction of the value of the trust assets;
- Relates to an amount that is permanently set aside for charitable purposes under a will or the terms of a trust unless both income and principal are so set aside;
- Will cause an individual to be treated as the owner of all or part of the trust for income tax purposes, and the individual would not be treated as the owner if the trustee did not possess the power to make an adjustment; and
- Will cause all or part of the trust assets to be included for estate tax purposes in the estate of an individual who has the power to remove a trustee or appoint a trustee, or both, and the assets would not be included in the estate of the individual if the trustee did not possess the power to make an adjustment.


Also, a trustee may not make an adjustment if he or she is also a beneficiary of the trust, or would benefit directly or indirectly by the power to adjust. Tex. Prop. Code Ann. § 116.005(c)(6-7) (Vernon Supp. 2010). For example, a spouse who is a trustee, but not a beneficiary, may lack the power to adjust if the distribution could be characterized as community property. When there is more than one trustee, the other co-trustees can make the adjustments unless the exercise of the power by the remaining trustee or trustees is not permitted by the terms of the trust. Tex. Prop. Code Ann. § 116.005(d) (Vernon Supp. 2010).

3. Presumptions of Fair and Reasonable

As to allocations between principal and income, a trustee is required to add a receipt or charge a disbursement to principal to the extent that the terms of
the trust and the new Principal and Income Act do not provide a rule for allocating the receipt or disbursement to or between principal and income. See Id. And, the Act provides that the actions of a trustee who follows the suggested allocations of the new Principal and Income Act is presumed to be fair and reasonable to all of the beneficiaries. Tex. Prop. Code Ann. § 116.004(b) (Vernon Supp. 2010).

C. Release of Power
Additionally, a trustee may release (permanently or temporarily) the power to adjust between income and principal when:

- The trustee is uncertain whether possessing or exercising the power will cause a result described in Section 116.005(c)(1)-(6) or (c)(8) (i.e., the adjustment limitations discussed above); or
- The trustee determines that possessing or exercising the power will or may deprive the trust of a tax benefit or impose a tax burden not described in the listed limitations.


The trustee may release the power permanently or for a specified period, including a period measured by the life of an individual. See Id.

D. Fiduciary Duties
Texas Trust Code Section 116.004 sets forth the general rules regarding a trustee’s fiduciary duties with regard to adjustments and the application of the new Principal and Income Act. Tex. Prop. Code Ann. § 116.004(a) (Vernon Supp. 2010). In short, the Act provides that a fiduciary shall administer a trust in accordance with the terms of the trust or the will, even if there is a different provision than the new act. See Id. When the will does not contain a different provision or give the fiduciary a discretionary power of administration, the fiduciary is required to administer a trust in accordance with new Principal and Income Act. See Id. Additionally, a trustee may administer a trust by the exercise of a discretionary power of administration given to the fiduciary under the terms of the trust, even if the exercise of the power produces a result different from a result required or permitted by the new Principal and Income Act. See Id.

VIII. EXERCISE OF DISCRETION
A. General Overview
As previously discussed, a trustee has a duty to administer the trust in accordance with its terms as set forth in the trust instrument and, to the extent not inconsistent, the provisions of the Texas Trust Code and Texas law. In doing so, the trustee has fiduciary duties to the beneficiaries of the trusts. See discussion supra. But, trustees do not owe fiduciary duties to third parties or those that may indirectly benefit from the terms of the trust such as an individual to whom a beneficiary owes a duty of support. Therefore, in exercising his or her discretion, the trustee should take into account what is in the best interest of the beneficiaries of the trust.

Furthermore, a trustee has a duty to reasonably exercise his or her discretion. This includes the trustee making informed decisions based primarily on the terms of the trusts and in a manner that carries out the settlor’s intent as set forth in the terms of the trust instrument. And, unless the agreement is ambiguous, the settlor’s intent must be determined solely by the terms and provisions of the trust as set forth in the trust agreement. See discussion supra.

B. Exercise Requires Action
As stated in the beginning of this article, paramount to the exercise of discretion is that the trustee must actually act to “exercise” his, her or its discretion. A trustee that establishes a process of determining the distributions to be made is less subject to challenge than a trustee distributing far less or far more with no process in place. Trustees that can present a well thought out and reasonable decision-making process are often victorious, even if their decisions appear to contradict the language of a trust, i.e. Penix v. First National Bank of Paris, 260 S.W.2d at 63, or the clear intent of the settlor, i.e., Coffee v. Rice, 408 S.W.2d 269 (Tex. 1966).

C. Relevant Information
In order to properly exercise his or her discretion, a trustee cannot make decisions in a vacuum. The trustee will generally need to obtain information from the beneficiary in order to make a fully informed distribution decision. Furthermore, a beneficiary may require certain information from the trustee in order to properly assess whether to make a distribution request and understand the manner in which the trustee decides to exercise his or her discretion.

1. Information Requested of Beneficiary

Relevant information may include the living expenses of the beneficiary and under the general rule of construction what other resources are reasonably available to the beneficiary for his support. Information that is commonly requested by trustees includes the following:

- Income and cash flow information;
- Financial statements;
- Copies of all trust documents under which the beneficiary has an right to funds or request a distribution;
- Copies of tax returns;
• Copies of all tuition and similar agreements relating to the beneficiaries’ education and maintenance;
• Copies of receipts or invoices as to any amounts to be reimbursed;
• Information regarding a beneficiaries employment status and efforts to obtain such employment;
• Status of the beneficiaries’ housing, medical insurance, and any other information regarding their support that the trustees deem relevant; and
• Notification of any significant changes in any beneficiary’s housing, education, development or medical needs.

While the preceding is not intended to be an exhaustive list or required in all situations, it provides a general listing of the information that may be periodically requested by a trustee to consider distribution requests and carry out the terms of the trust.

Perhaps one of the more difficult issues is the information that a trustee feels he or she requires to justify a distribution. Some trustees desire to obtain extensive information from the beneficiary to “paper” their file, however, this can lead to feelings of ill-will and invasion of privacy towards the trustee. Other trustees go to the opposite extreme and request no information. This can lead to claims of breach of fiduciary duty against the trustee by the other beneficiaries who may eventually request that the trustee justify his or her prior distributions. In acting, “the trustee generally may rely on the beneficiary’s representations and on readily available, minimally intrusive information requested of the beneficiary.” But when the trustee has reason to believe that the information is incomplete or inaccurate then the trustee should request additional information.

2. Information Provided by the Trustee

Information regarding distributions is a two-way street. Just as a trustee may seek information to support a distribution, a beneficiary is entitled to information in order to request a distribution or justify a trustee’s decisions whether to make a distribution. The Restatement (Third) of Trusts provides that among a trustee’s fiduciary duties is the (i) general duty to act, reasonably informed, with impartiality among the various beneficiaries and interests (Section 79) and (ii) duty to provide the beneficiaries with information concerning the trust and its administration (Section 82). The Restatement concludes “this combination of duties entitles the beneficiaries (and also the court) not only to accounting information but also to relevant, general information concerning the bases upon which the trustee’s discretionary judgments have been or will be made. See Restatement (Third) of Trusts § 50 cmt g (general observations on relevant factors in the interpretation of discretionary powers).

D. Judicial Review

1. Common Law

There are two basic principles that can be derived from the case law in Texas. They allow courts the latitude to take whatever action they deem necessary according to the facts in each situation. The first principle is that courts will not second guess the trustee unless there is an “abuse of discretion.” Coffee, 408 S.W.2d at 269. This rule is still valid today: “Texas courts are prohibited by law from interfering with the discretion of the trustee absent a clear showing of fraud or other egregious conduct.” In re Bass, 171 F.3d 1016 (5th Cir. 1999). The second principle is that any decision by the trustee that subverts the “intent of the settlor” will be overturned. State v. Rubion, 308 S.W.2d at 4.

The logical conclusion to be drawn from these two principles is that the “intent of the settlor” is the paramount consideration when a trustee is exercising its discretion. A closer look at these seemingly clear principles reveals that the courts have not actually provided any real guidance. The case law only leads the trustee back to the place in which it started. After all, if the settlor’s intent is abundantly clear to all parties then there would be no need for court intervention in the first place. Furthermore, it is apparent from reading the actual cases that settlor’s intent is often in reality second fiddle to a trustee’s discretion. See Coffee, 408 S.W.2d at 269. While this line of thinking does not serve those of us who would like better guidance in this area, it does allow the courts the freedom to evaluate either principle on a case-by-case basis. Thereby granting the courts a position of authority whether they uphold the trustee’s decision, or the complaining plaintiff’s allegation of foul play.

For example, a recent Michigan case illustrates how broadly a trustee’s discretion can be interpreted. In In re John Kotsonis Irrevocable Family Trust, 2007 WL 4126669 (Mich.App. Nov 20, 2007)(unpublished opinion), the Michigan Appellate Court upheld the trial court’s finding that a trustee acted in good faith and with proper authority when he changed the beneficiary of a trust owned life insurance policy from the trust to all but one of the trust beneficiaries. The appellate court also upheld the trial court’s modification of the trust that resulted in the removal of the excluded beneficiary as a beneficiary of the trust. In reaching its decision, the court reviewed the terms of the trust instrument. It found the terms authorized the trustee to change the beneficiary of a life insurance policy. It also found the change in designation was essentially a distribution from the trust and the trust terms authorized the trustee to make “equal or unequal” distributions. Id at *2. And, the court considered that a trustee has an
obligation to preserve trust assets and the change was made so that the grantor would continue to pay the annual premiums. Based on these facts, the appellate court held that the trustee’s actions were proper. Id. at 269. Therefore, it can reasonably be inferred that courts are likely to intervene when the court sees fit under the terms of the trust instrument. However, as discussed above, the courts have consistently intervened when they feel that the “intent of the testator” has been subverted.

(ii). Misinterpretation of the Trust.
Note that the Restatement also includes intervention to prevent a “misinterpretation” of the trust. In comment b. to Subsection (1) the Restatement provides:

“Court intervention may be obtained to rectify abuses resulting from bad faith or improper motive, and to correct errors resulting from mistakes of interpretation. Absent language of extended (e.g. “Absolute” or “uncontrolled” discretion (Comment c), a court will also intervene if it finds the payments made, or not made, to be unreasonable as a means of carrying out the trust provisions.”

2. Texas Trust Code

Until the enactment of Texas’ version of the Uniform Principal and Income Act in 2004, there was limited statutory authority for a court to review a trustee’s distribution decisions. For example, the Texas Trust Code provided that a district court (and statutory probate courts under their enabling legislation) had jurisdiction over all proceedings concerning trusts, including those relating to (i) making determinations of fact that affect distributions from a trust, (ii) determining a question arising in the distribution of a trust, and (iii) relieving a trustee from any or all of the duties, limitations, and restrictions otherwise existing under the terms of the trust instrument or of this subtitle. See Tex. Prop. Code Ann. § 115.001(a) (Vernon 1995 & Supp. 2010). The Texas Trust Code, however, did not provide any additional guidance. Thus, trustees and beneficiaries generally sought relief under the declaratory judgment provisions set forth in the Texas Civil Practice & Remedies Code. See Tex. Civ. Prac. & Rem. Code Ann. § 37.005 (Vernon Supp. 2010)(person interested in trust may seek judicial declaration of rights or legal relations in respect to trust to direct the trustees to do or abstain from doing any particular act in their fiduciary capacity or determine any question arising in administration of trust).

Now, Texas Trust Code Section 116.006 provides for judicial review of a trustee’s decisions relating to adjustments to income, which may directly or indirectly affect a trustee’s distribution decisions. Texas Trust Code Section 116.006 allows a trustee to seek a court declaration (in certain cases) that a contemplated adjustment will not be a breach of trust. There are limitations on a trustee’s right to pursue such a determination. Furthermore, Section 116.006 addresses the payment of a trustee and beneficiary’s legal fees relating to a judicial proceeding. It includes a requirement for the trustee to advance attorney’s fees related to the proceeding from the trust; however, it also permits the court to charge these fees between or among beneficiaries.

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the trust, the trustee, individually, or one or more beneficiaries (or their trust interests), at the conclusion of the proceeding based on the circumstances. And, Section 116.006 was recently modified by the 2009 Texas Legislature to include costs and reasonable attorney’s fees of any attorney ad litem. Before a trustee considers initiating a judicial proceeding, it is advisable to determine if a non-judicial means exists to resolve any issues involving a contemplated principal/income adjustment. Section 116.006 requires that before a trustee may initiate a judicial proceeding: (i) a trustee makes reasonable disclosure to all beneficiaries and (ii) has a reasonable belief that a beneficiary will object to the proposed allocation. Some means to determine if an objection exists may include:

- Written notification of the proposed allocation to all trust beneficiaries including, clear communication as to the effect of the allocation (reduced principal, etc.);
- Request that the beneficiary advise the trustee if he objects or consents to the distribution;
- Request that the beneficiary indicate his or her consent in writing (perhaps provide written consent forms); and
- Inform beneficiaries that if they have any questions, they should seek counsel before signing any documents or responses.

But, the refusal of a beneficiary alone to sign a waiver or release is not reasonable grounds for a trustee to claim that the beneficiary will object to the adjustment or allocation. See Id.

IX. RELATED ISSUES AND CONSIDERATIONS

A. Spendthrift Clauses

In a support trust, discussed supra, the inclusion of a spendthrift clause generally makes it difficult for a creditor of the beneficiary to successfully assert a claim against the trust assets. Since the beneficiary’s only enforceable claim against the trustee is to compel a distribution for support, creditors asserting claims in the shoes of the beneficiary can only assert the interest of the beneficiary.

Moreover, the inclusion of a spendthrift clause in a support trust normally prevents the beneficiary from assigning or otherwise alienating his or her rights under the trust in favor of a creditor or other third party. See also discussion of beneficiary serving as trustee supra. An exception to the general rule arises in certain instances where the beneficiary has received support and other care from the state or other public agency or owes a duty to support to a child. A governmental agency asserting a claim against the trust assets of a beneficiary for whom institutional care has been furnished, will have a stronger case against a support trust as opposed to a discretionary supplemental or special needs trust. See Rubion, 308 S.W.2d at 8.

As to child support, a trustee of a support trust may be required to make distributions for the support of the beneficiary’s child. See Tex. Fam. Code Ann. § 154.005 (2002) (“The court may order the trustees of a spendthrift or other trust to make disbursements for the support of a child to the extent the trustees are required to make payments to a beneficiary who is required to make child support payments as provided by this chapter.”).

On the other hand, if the trust is a pure discretionary trust, the court may order payments for the benefit of the child from income but not principal. See Id. (“If disbursement of the assets of the trust is discretionary, the court may order child support payments from the income of the trust but not from the principal.”); see also discussion supra.

B. Facility of Payment Clauses

Consideration should be given to the facility of payment clauses. When well drafted, it can provide a trustee greater flexibility in making distributions. For example, a facility of payment provisions may be beneficial when a beneficiary has a substance abuse problem. It may allow the trustee to make distributions to persons other than the beneficiary when it would not be in the beneficiary’s interest to do so. For example, if the trustee is required to make certain distributions but the beneficiary is a minor or unable to properly manage his or her affairs, the trustee may instead make the distribution in an alternatively manner including, but not limited to:

- To the beneficiary directly;
- Directly for the benefit of the Beneficiary;
- To the natural or legal guardian of the beneficiary person or estate;
- To a parent of a minor or adult disabled beneficiary;
- To a managing or possessory conservator of a minor or adult disabled beneficiary;
- To an agent under a power of attorney;
- To a person or entity who has properly advanced funds to the beneficiary or who will apply the distribution for the benefit of the minor;
- To a new trust, the trustee, trust protector or other person is entitled to create to segregate and manage the funds for the beneficiary;
- To a custodian for the beneficiary under a Uniform Gift or Transfers to Minors Act,
• To the trustee of a special needs or miller trust;
• To a person caring for the beneficiary, such as a spouse or other family member; or
• To a guardian ad litem or other court appointed fiduciary in the judgment of the trustee.

The facility of payment clause should not, however, create a restriction that causes unintended tax consequences. For example, care must be taken to not limit a QTIP trust’s distributions in a manner than would result in the denial of the marital deduction. For example, Technical Advice Memorandum 8901008 involved a trust that granted the trustee discretion in such a manner that the surviving spouse may not receive, or be entitled to receive all of the income. (Jan 6, 1989; (citing Estate of Frank E. Tingley v. Commissioner, 22 T.C. 402 (1954) aff’d sub nom. Starrett v. Commissioner, 223 F.2d 163 (1st. Cir 1955)(marital deduction was denied for trust containing facility of payment clause under which surviving spouse's right to request income ceased in case of legal incapacity and trustee was thereafter given full power and discretion to use and apply such part of net income for benefit of spouse as trustee deemed wise and proper). As such, when the trust instrument is silent with respect to the disposition of any undistributed income, and state law does not provide a mandatory distribution requirement of accumulated and undistributed income, trustee is deemed to have the power to accumulate any income in excess of the discretionary distributions made by the trustee under the facility of payment clause of the trust. Because of the trustee's potential power to accumulate trust income, the requirement of Section 2056(b)(5) of the Internal Revenue Code was not satisfied. See Id.

In contrast, in Revenue Ruling 85-35, the trustee was required to distribute all of the income under the facility of payment clause and the surviving spouse was, therefore, to receive all of the income or the benefit of all of the income. Likewise, the issue in Technical Advice Memorandum 8503009, was whether a facility of payment clause that granted the trustee a discretionary power to apply or pay the trust income for the exclusive benefit of the settlor's wife in the event of her disability, violated Section 2056(b)(7) of the Internal Revenue Code. (Oct 1, 1984). The Service found that the “facility of payment clause created under the Decedent's Will granting the trustee discretionary power to apply or pay the trust income for the exclusive benefit of the settlor's wife in the event of her disability does not violate section 2056(b)(7) of the Internal Revenue Code which requires that the surviving spouse be entitled to all of the income from the property, payable annually or at more frequent intervals. See Id.

C. Definition of Incapacity

Consideration should be given to how and when a beneficiary will be considered incapacitated and how that will affect trust distributions. A determination of a beneficiary’s capacity is sometimes more difficult because he or she has typically not executed the trust agreement or otherwise entered into a contractual relationship that authorizes the disclosure of the beneficiary’s medical or mental health information. Therefore, a determination of a beneficiary’s incapacity should be drafted to provide the trustee greater flexibility when a physician cannot certify the beneficiary’s capacity. For example, the document may define incapacity of a beneficiary as follows:

An adult individual beneficiary under this [Will/Trust] shall be considered incapacitated upon a good faith determination made by the fiduciary charged with making such evaluation that such individual lacks the physical or mental capacity, personal or emotional stability or maturity of judgment needed to effectively manage his or her personal or financial affairs (whether because of injury, mental or medical condition, substance abuse or dependency, or any other reason). Individuals under the age of majority shall be considered legally incapacitated.

If possible, documents should provide a general means to avoid disputes based on a beneficiary’s capacity. These provisions provide a method to mitigate disputes and resolve differences in a less adversarial manner. Furthermore, the courts will generally enforce the terms of the trust provided they are not void as a matter of law or against public policy. Arbitration provisions can provide a valid process in which parties may resolve these disputes outside a public litigation. Possible processes to resolve or avoid disputes based on incapacity may be as follows:

• Arbitration provisions;
• Presumption of capacity unless the person at issue has been adjudicated to be incapacitated by a guardianship proceeding in the State of Texas;
• Presumption of capacity unless two or more doctors certify that such person lacks the requisite capacity;
• Requirement that the person in issue submit to a mental and physical exam within 30 days of written request by a trustee, agent or client, or be presumed to be incapacitated for purposes of the governing document; and
• Authorization to withhold distributions (but be careful of QTIP limitations) in certain circumstances.

D. Dealings With A Guardian

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Consideration should be given to whether the trustee may make distributions to third parties who may be providing housing or other care to the beneficiary. While such distributions may be allowed under a HEMS standard, the trustee may be second guessed for such distributions unless the trust instrument provides for such a possibility. For example, the instrument may provide as follows:

The Trustee, in making any distributions for the benefit of any legally incompetent beneficiary, shall give liberal interpretation to the discretionary authority conferred by this Will in order to alleviate any burden on the legal guardian of the person of any legally incapacitated beneficiary and on such guardian's family which might be caused in any way by the presence of the beneficiary in the guardian's home, all to the end that each beneficiary and the guardian of his or her person be able to maintain, as nearly as possible, the standard of living to which each has been accustomed.


E. Ability To Gift Trust Assets or Distributions
An issue that seems to be raised with increasing frequency is the ability, if any, of a trustee to make distributions to a beneficiary for purposes of the beneficiary making a gift. For example, in a recent case, the beneficiary requested a trust distribution to benefit the settlor. In Portanova v. Monroe, 229 S.W.3d 324, (Tex.App.—Houston [1st Dist.] 2006, pet denied.). Unfortunately, no Texas appellate court has considered this issue to date. See Id. (court never reached issue of whether ward's best interest would be served by having trust funds distributed to trustee for non-beneficiary because court held that beneficiary did not present a justiciable controversy, as trust was a discretionary trust and trustees had exercised their discretion by declining to fund proposed trust). Other states that have considered this issue have generally held that unless the terms of the trust expressly authorizes it, a trustee is not permitted to make a gift from the trust. See City of Jacksonville v. Bankers Life Co., 90 F.2d 141, 144 (7th Cir. 1937); Hill v. Thompson, 564 So.2d 1, 6 (Miss. 1989); In re Koretsky’s Estate, 86 A.2d 238, 247 (N.J. 1951); Clune v. Norton, 28 N.E.2d 229, 231 (Mass. 1940); Park Falls State Bank v. Fordyce, 238 N.W. 516, 520 (Wis. 1931); Julian v. Reynolds, 8 Ala. 680, 1845 WL 328 at * 2 (Ala. 1845); Wright v. Wright, No. 01-0108, 2002 WL 1071934 at *3 (Iowa Ct. App. May 31, 2002) (unpublished opinion).

Of course, a trustee may make a gift of trust property if the trust expressly permits the making of such gifts. See Succession of Simpson, 311 So.2d 67, 70 (La. Ct. App. 1975). For example, in Henshie v. McPherson and Citizens State Bank, 280 P.2d 937 (Kan. 1955), the terms of the trust provided:

it being my desire that my said trustees in making expenditures for my said daughter shall in every way do all that is possible to see that she is comfortable and well cared for and that she shall have sufficient money to make all reasonable contributions to any church or benevolences as she may desire, or to her relatives as she may desire.

See Id. at 950 (the trustee was authorized to distribute $50 to a stranger as a 50th anniversary present and $25 to the St. Francis Boy’s Home, both of which were the stated desire of the beneficiary). 

F. Trustee Removal Provisions
The ability to remove a trustee without court intervention must be balanced with the desire for the trustee to serve as an independent gatekeeper. These trustee removal provisions are often used by disgruntled beneficiaries to chill a trustee’s ability to independently exercise his, her or its discretion. Therefore, the right should not be given to a person who may use it to “blackmail” trustees into favorable decisions. The following are some considerations when drafting these removal provisions:

- Whether there should be a limit on when and how often a trustee may be removed, i.e., not for 2 years after funding, only every 2 years, etc.;
- Whether the removal right should be limited to an independent trust protector or third person;
- Whether a trustee’s removal should be only on the basis of good cause;
- Whether a beneficiary’s needs to reach a certain age prior to having the right to remove a trustee; and
- Whether both a majority of the adult incapacitated current and remainder beneficiaries should agree on the trustee’s remove.

And, some suggestions include:

- If settlor would have distributed the assets outright to the beneficiary except for creditor or tax issues, an unlimited removal right may be appropriate;
- In situations where the settlor wants to provide for different beneficiaries, protect a spendthrift beneficiary, etc., the removal right should be restricted to avoid retaliatory removals;
- Do not allow removal for 2 years following the funding of a trust and not more than every two years;
• If there is a primary beneficiary, he or she should be provided a reasonably limited removal right;
• If the trust is a pot trust primarily for a single generation with similar resources and needs, consider granting them a removal right by majority;
• If the trust is a pot trust with multiple generations, consider limiting removal to a independent trust protector or third person;
• Do not limit a trustee’s removal to good cause as it generally results in litigation;
• Limit beneficiary removal rights to a certain age;
• Allow removal of both individual and corporate trustees, but consider if they should be subject to different removal standards; and
• If remainder beneficiaries are given removal rights, provide a means to identify who shall be included in the class or group.

X. RESIGNATION PROVISIONS

A. When Can A Trustee Resign?
A trustee may resign in accordance with the terms of the trust instrument or by petitioning a court for permission to resign. TEX. PROP. CODE ANN. § 113.081 (Vernon 2007). If by petition to the court, the court may accept a trustee's resignation and discharge the trustee from the trust on the terms and conditions necessary to protect the rights of other interested persons. See Id.

B. Do I Need A Provision Dealing With Resignation?
As with appointment provisions, it is preferable to include a clear resignation procedure in the trust instrument as opposed to relying on the statutory default provision. Such provisions often avoid the time and cost involved with a judicial proceeding.

C. Draft For Transition Rather Than Just Resignation
These provisions should do more than simply provide that a trustee can resign. They should provide a means to transition to a new successor trustee after appropriate notice to the beneficiaries. When drafting these provisions, consideration should be given to the following:

- Who should receive notice: all beneficiaries, current beneficiaries, trustee appointees, trust protector and/or advisor, etc.;
- How notice should be given;
- Means for delivery of notice;
- Time period before resignation is effective;
- Ability of certain persons or entities to waive the notice time period;
- What happens if no successor trustee is appointed at the time the resignation is effective;
- Right of resigning trustee to seek a judicial acceptance and/or settlement notwithstanding resignation provisions.

Unless the trust has vested remaindermen, it may be difficult for a resigning trustee to notice every potential beneficiary of a trust. For example, the following provisions can lead to questions when and whether a resignation is effective:

Any trustee or cotrustee acting hereunder may resign as a trustee or cotrustee of any trust created herein, without obtaining the order of any court, by giving at least 30 days prior written notice (unless waived) to (i) all adult beneficiaries of such trust and (ii) the parents or guardians of all other beneficiaries of who are then under a legal disability.

Thus, consideration should be given to limiting required notice to current beneficiaries and those remainder beneficiaries who have a vested interest, are readily ascertainable, and/or have a material interest in the trust. This is not to say that the resigning trustee should not make a good faith attempt to inform all possible beneficiaries, but the resignation should not be contingent upon such notice. For example, the notice provision may provide:

A trustee may resign as trustee of any one or more trusts created under this instrument at any time, with or without cause, by delivering a resignation notice in recordable form (i) to each adult beneficiary of the trust who is then permitted to receive distributions from the trust and (ii) to each serving cotrustee, if any.

And, when providing how notice should be delivered, the trust agreement should provide a means that is reasonable to accomplish. For example, the following provisions may result in issues regarding delivery:

Any notice or election required or permitted to be given by or to a trustee acting under this instrument must be given by acknowledged instrument actually delivered to the person or fiduciary to whom it is required or permitted to be given. Any notice required or permitted to be given to a minor or an incompetent shall be given to such minor’s parents or guardian or to such incompetent’s guardian. If such notice concerns a trusteeship, it shall state its effective date and shall be given at least 30
days prior to such effective date, unless such period of notice is waived.

Likewise, the agreement should clarify when the acceptance is effective. Many trust agreements require the appointment prior to the effectiveness of the resignation. This ensures that a trustee remains in place. But, in certain cases, this has lead to a trustee remaining an indentured servant for longer than he or she contemplated. Even when such requirement is contemplated, the trust instrument should not impose requirements beyond receipt of notice of acceptance by the successor trustee. For example, one trust instrument provided that the “trustee’s resignation shall be effective only upon the acceptance and qualification of the successor.” There is no procedure for a trustee to qualify under the Texas Trust Code.

D. Clarify A Resigning Trustee Can Seek A Judicial Release & Discharge

Finally, it has been argued that a trustee cannot be reimbursed for the cost of seeking a judicial resignation and discharge when the instrument provides for a non-judicial means to resign. To provide some protection for the trustee, the trust instrument may clarify the resigning trustee’s right to seek a judicial discharge by expressly authorizing it in the trust instrument as follows:

Notwithstanding any provision in this instrument to the contrary, any trustee may resign as trustee of any one or more trusts created under this instrument at any time, with or without cause, by filing a petition with any court having jurisdiction and venue of such trust seeking to resign, immediate or contingent upon such trustee’s release and discharge. And the trustee shall be entitled to pay from the trust assets and/or seek reimbursement for all costs, including legal and accounting fees and expenses, related to the proceeding.

E. Clarify If A Resigning Trustee Can Retain Trust Assets Pending A Judicial Release & Discharge

Although, the Texas Trust Code authorizes a trustee to wind-up the affairs of the trust, what is not addressed is whether a resigning trustee can retain trust assets pending his, her or its release and discharge. This creates an issue when a successor trustee demands the trust assets. To avoid future disputes, consideration should be given to whether to expressly authorize a trustee to do so.

XI. REMOVAL PROVISIONS

A. When Can A Trustee Be Removed?

Texas Trust Code Section 113.082 provides for the removal of a trustee as follows:

(a) A trustee may be removed in accordance with the terms of the trust instrument, or, on the petition of an interested person and after hearing, a court may, in its discretion, remove a trustee and deny part or all of the trust fund to the trust.

(1) the trustee materially violated or attempted to violate the terms of the trust and the violation or attempted violation results in a material financial loss to the trust;

(2) the trustee becomes incapacitated or insolvent;

(3) the trustee fails to make an accounting that is required by law or by the terms of the trust;

(4) the court finds other cause for removal.

TEX. PROP. CODE ANN. § 113.082 (Vernon 2007).

In addition to these specified statutory grounds, a court may remove a trustee on any grounds that the court considers necessary and proper. See Novak v. Schellenberg, 718 S.W.2d 822 (Tex. App.—Corpus Christi 1986, no writ). For example, lack of business experience has been considered on the question of the removal of a trustee. See Moore v. Sanders, 106 S.W.2d 337 (Tex. Civ. App.—San Antonio 1937, no writ). But, ill will or hostility between the trustee and the beneficiary of the trust, standing alone, is not a sufficient ground for removal of the trustee from office. See Akin v. Dahl, 661 S.W.2d 911 (Tex. 1983). The burden of proof is on the party who seeks to remove a trustee for dereliction of duty. See Novak, 718 S.W.2d at 822.

B. Do I Need A Provision Dealing With Resignation?

In short, yes. A power of removal can be a vital tool when creating a balance between the powers of the trustee and protection of the beneficiaries. It also allows the settlor to expressly provide when the removal rights should be broader or more restrictive than the statutory grounds.

In the absence of a removal right under the trust instrument, the beneficiary will be forced to seek removal under the Texas Trust Code. This can be a long and expensive process if the trustee refuses to resign and forces a judicial removal.
C. Draft to Create a Balance Between the Trustee and the Beneficiary

The ability to remove a trustee without court intervention must be balanced with the desire for the trustee to serve as an independent gatekeeper. These trustee removal provisions are often used by disgruntled beneficiaries to chill a trustee’s ability to independently exercise his, her or its discretion. Therefore, the right should not be given to a person who may use it to “blackmail” trustees into favorable decisions.

The following are some considerations when drafting these removal provisions:

- Whether there should be a limit on when and how often a trustee may be removed, i.e., not for 2 years after funding, only every 2 years, etc.;
- Whether the removal right should be limited to an independent trust protector or third person;
- Whether a trustee’s removal should be only on the basis of good cause;
- Whether a beneficiary’s needs to reach a certain age prior to having the right to remove a trustee; and
- Whether both a majority of the adult capacitated current and remainder beneficiaries should agree on the trustee’s remove.

And, some suggestions include:

- If settlor would have distributed the assets outright to the beneficiary except for creditor or tax issues, an unlimited removal right may be appropriate;
- In situations where the settlor wants to provide for different beneficiaries, protect a spendthrift beneficiary, etc., the removal right should be restricted to avoid retaliatory removals;
- Do not allow removal for 2 years following the funding of a trust and not more than every two years;
- If there is a primary beneficiary, he or she should be provided a reasonably limited removal right;
- If the trust is a pot trust primarily for a single generation with similar resources and needs, consider granting them a removal right by majority;
- If the trust is a pot trust with multiple generations, consider limiting removal to a independent trust protector or third person;
- Do not limit a trustee’s removal to good cause as it generally results in litigation;
- Limit beneficiary removal rights to a certain age;
- Allow removal of both individual and corporate trustees, but consider if they should be subject to different removal standards; and
- If remainder beneficiaries are given removal rights, provide a means to identify who shall be included in the class or group.

If an unlimited removal right is sought, the instrument should grant this right. A sample provision follows:

My [spouse, child, descendant, beneficiary, trust advisor/protector, trustee appointer] may at any time remove any trustee of any trust, with or without cause, and may appoint a successor individual or corporate trustee.

The following limits removal to only corporate trustees:

The [spouse, child, descendant, primary beneficiary, trustee appointer, trust protector and/or advisor, etc.] may remove any bank or other corporation serving as trustee of any trust at any time, with or without cause, and appoint a qualified corporation (as defined in Section ____) as successor trustee of such trust.

A provisions granting the removal right to a trust protector may provide as follows:

a). Trustee Removal And Appointment Authority. Without regard to any other provisions of this instrument, the Trust Protector (defined in Section __) shall have the following powers, which are exercisable from time to time and at any time.

i). Trustee Removal. The Trust Protector may remove any trustee of any trust created by or pursuant to this instrument.

ii). Trustee Appointment. The Trust Protector may appoint an additional trustee or additional trustees of any trust created by or pursuant to this instrument. The Trust Protector may also appoint a successor or successors trustee of any trust created by or pursuant to this instrument in the event any trustee is removed, resigns or otherwise ceases to act. Provided, however, any appointment of an additional trustee or successor trustee may be changed by the Trust Protector prior to the time it becomes effective.
b). Trustee Appointment And Removal Procedures.

i). Generally. Every appointment (or removal) of a trustee must be evidenced by a written instrument in recordable form, signed by the Trust Protector and delivered to the appointee (or trustee being removed). The instrument must identify the appointee (or trustee being removed), state the effective time and date of appointment (or removal), and every appointment must contain an acceptance by the appointee. Except as otherwise provided, every trustee appointed under this instrument must be either a qualified corporation or one or more qualified individuals (defined below).

ii). Delivery Of Trust Estate. Upon the appointment of a successor trustee, the trustee shall immediately stand possessed of the estate of such trust for the new trustee or trustees, and shall transfer the same to the new trustee or trustees as soon as possible, so that such estate shall continue to be held upon the applicable trust or trusts hereof, but subject to and governed by the laws of the applicable jurisdiction, whether the State of Texas or a new jurisdiction designated by the Trust Protector to govern any trust established by or pursuant to this instrument.

But, as suggested above, consider limiting the right to remove to not more than every 2 years. Thus, the following could be include:

Provided, however, no [spouse, child, descendant, beneficiary, trustee appointer, trust protector and/or advisor] shall have the authority to remove any bank or other corporation serving as trustee of any trust, within the first 24 full calendar months of that bank or other corporation’s appointment as trustee of that trust.

XII. DELEGATION OF DUTIES.

A. The ‘General Rule’

The trustee’s duty of competence generally includes restrictions on delegating fiduciary duties. Except as allowed by law, the trustee is under an obligation to personally administer the trust and is under a duty not to delegate to others acts that the trustee should personally perform. But, unless the trust instrument provides otherwise, a trustee may delegate to his or her cotrustee the performance of a trustee's function. TEX. PROP. CODE ANN. § 113.085(e)(Vernon 2007 & Supp 2009) as Amended by Acts 81st Legislature ch. 973 § 1, effective September 1, 2009.

B. Delegation Between Cotrustees

A trustee may delegate to his or her cotrustee the performance of a trustee's function unless prohibited by the trust. See TEX. PROP. CODE ANN. § 113.085(e)(Vernon 2007). The delegation is presumed to be revocable unless otherwise stated.

Therefore, when naming cotrustees, the settlor should keep in mind that one cotrustee may appoint another to function as an agent for those duties that may lawfully be delegated unless he or she expressly prohibits delegation as between cotrustees. TEX. PROP. CODE ANN. § 113.085(e)(Vernon 2007; see also Bunn v. City of Laredo, 213 S.W. 320 (Tex. Civ. App.—San Antonio 1919, no writ). For example, if only one of several trustees qualifies to act as an agent, a deed by that one alone will pass title to a purchaser under Texas law. Thus, when the settlor does not want to his or her trustees to have this power, the trust instrument should clearly provide otherwise.

C. Delegation to Non-Trustees

As discussed previously, the trustee is under an obligation to personally administer the trust and is under a duty not to delegate to others acts that the trustee should personally perform except as authorized by the instrument or Texas law. Therefore, if the settlor wants his or her trustees to have this ability, the trust instrument should clearly provide what duties can be delegated. For example, trust agreements have historically authorized trustees to delegate investments decisions to investment advisors. This was necessary because prior to September 1, 1999, there was a question as to whether trustees of a trust could properly delegate the power to make or retain investments to an investment counselor or a bank.

But, it is no longer necessary to authorize the delegation of investments or management decisions. The Texas Trust Code was amended effective September 1, 1999 to specifically permit a trustee to employ an investment agent, in addition to employing attorneys, accountants, agents, and brokers reasonably necessary in the administration of the trust estate. TEX. PROP. CODE ANN. § 113.018 (Vernon 2007). Section 117.011 permits a trustee to delegate investment and management decisions to an agent if certain conditions are met, and subject to certain limitations. TEX. PROP. CODE ANN. § 117.011 (Vernon 2007). The trustee is not responsible for the decisions of the agent provided the trustee exercises the appropriate judgment and care in selecting the agent (and meets the statutory requirements). This includes establishing the scope and terms of the authority delegated to the agent, investigating the agent’s credentials (including the
agent’s performance history, experience, and financial stability), verifying the agent’s professional license and registration, and confirming that the agent is bonded and insured. *Id.*

**XIII. ACCOUNTING & ACCOUNTABILITY**

**A. The ‘General Rule’**

A trust beneficiary may make a written demand on the trustee for an accounting covering all transactions since the last accounting, or since the creation of the trust, whichever is later. *See TEX. PROP. CODE ANN. § 113.151(a) (Vernon 2007).* And, if the trustee fails or refuses to deliver the accounting within 90 days of the request, unless extended by a court, the beneficiary of the trust may file suit to compel the trustee to do so. *See Id.* If the court finds that the beneficiary’s interest in the trust is sufficient to require an accounting by the trustee, it may order the trustee to account to all the trust beneficiaries. *See Id.* But, a trustee is not required to account more frequently than once every 12 months unless ordered to do so by the court. *See Id.* Also, if a beneficiary successfully compels an accounting, the court may, “in its discretion, award all or part of the costs of court and all of the suing beneficiary’s reasonable and necessary attorney’s fees and costs against the trustee in the trustee's individual capacity or in the trustee's capacity as trustee.” *See Id.*

Likewise, an interested person may file suit to compel the trustee to account to the interested person. *TEX. PROP. CODE ANN. § 113.151(a) (Vernon 2007).* If the court finds that the nature of the interest, the claim against the trust, or the effect of the trust administration on the interested person is sufficient to require an accounting by the trustee, the court may require the trustee to account to the interested person. *See TEX. PROP. CODE ANN. § 113.151(b) (Vernon 2007).*

If prepared under the Texas Trust Code, Section 113.152 provides that the accounting must include:

1. all trust property that has come to the trustee’s knowledge or into the trustee’s possession and that has not been previously listed or inventoried as property of the trust;
2. a complete account of receipts, disbursements, and other transactions regarding the trust property for the period covered by the account, including their source and nature, with receipts of principal and income shown separately;
3. a listing of all property being administered, with an adequate description of each asset;
4. the cash balance on hand and the name and location of the depository where the balance is kept; and
5. all known liabilities owed by the trust.

*TEX. PROP. CODE ANN. § 113.151(a) (Vernon 2007).*

With regard to an irrevocable trust, the settler may not limit any common law duty to keep a beneficiary age 25 or older informed during the time period that the beneficiary “(i) is entitled or permitted to receive distributions from the trust; or (ii) would receive a distribution from the trust if the trust terminated at the time of the demand.” *See TEX. PROP. CODE ANN. § 111.0035(c) (Vernon 2007).* But, a settlor has the ability to modify the account requirements as to other trusts and beneficiaries. And, in the right circumstances should do so.

**B. Is It Necessary To Include Provisions Dealing With An Accounting?**

An accounting provision is not necessary as the Texas Trust Code provides a fair means to provide an accounting. But, the Texas Trust Code does not address the many issues that are attendant to the accounting, such as cost, access to books and records, right of remainder beneficiaries of revocable trusts, etc. Thus, these provisions can modify and clarify a fiduciary’s duty to account. And, by doing so, they can reduce future disputes and costs. Therefore, consideration should be given to:

- The duty of a fiduciary to account;
- Who can demand an accounting;
- Whether the burden is on the fiduciary to provide a periodic accounting or whether the beneficiary must request an accounting;
- The type of accounting and/or supporting information should be provided;
- How often an accounting will or should be provided;
- How the cost of the accounting will be allocated; and
- How the cost of any demanded audit should be allocated.

**C. Mandatory Versus On Request**

It is recommended that the right of primary and vested beneficiaries to request an accounting be confirmed in the trust agreement. But, a requirement for the preparation and distribution of mandated accountings should be avoided unless (i) a corporate trustees is serving, and (ii) the beneficiaries to whom the accounting is mandated are reasonably identified and located. For example, the trust agreement may provide:
Any trustee shall furnish an annual accounting to any beneficiary or guardian of any minor or incapacitated beneficiary upon reasonable demand made therefore. If and to the extent required by a successor trustee, an accounting for the administration of a trust created under this instrument shall also be given to the successor trustee. A successor trustee shall be fully protected in relying upon such accounting and also in not requiring such an accounting from his or her predecessor.

Note that the failure of a fiduciary to comply with accounting requirements may lead to claims of breach of trust and grounds for removal. Therefore, provisions placing the obligation on the fiduciary to provide an accounting to certain beneficiaries regardless of a request should be avoided unless warranted under the particular facts and circumstances. For example, the following provisions can result in an inadvertent breach of trust by a trustee:

The trustee shall make annual statements showing the itemized receipts and disbursements of the income and principal of the trust, and otherwise reflecting the condition thereof, and shall furnish copies of such statements to each beneficiary of the trust.

D. Form of the Accounting

If an accounting is demanded, it is advisable to incorporate the form of the accounting set forth in the Texas Trust Code. This provides clear guidance to the trustee and will avoid duplication in the event of a subsequent lawsuit.

But, additional accounting requirements should be used with caution. They can add unnecessary cost to the administration of the trust, particularly if only one beneficiary is interested in such additional information. And, they can create duties that are difficult for a trustee to fully satisfy. For example, the following request can set up a trustee for claims of non-compliance and breach of trust even if a good faith effort is made:

If any beneficiary requests, a profit and loss statement, fully disclosing the fiscal operations of the trust for the preceding year, and a balance sheet, which accurately reflects the financial status of the trust at the expiration of the preceding year, shall be furnished to the beneficiary within ninety days of the end of the fiscal year.

E. Access To Books & Records

A beneficiary should be given reasonable access to the books and records of the trust. But, a mandated open door policy is not reasonable. For example, the following can allow a beneficiary to make unreasonable demands:

The trustees shall keep (or cause to be kept) accurate books of account reflecting all of the receipts and disbursements of the trusts. Each beneficiary shall have free access to all the trust books, records, and accounts at all reasonable times during regular business hours.

Likewise, the beneficiary’s rights should not be restricted to the whims of the trustee. Attempting to create a balance can be difficult, but one approach is as follows:

The trustees shall maintain the books and records of the trust. A beneficiary then entitled to received distributions and/or with a vested remainder interest shall be entitled to periodically (i) review the trust books and records upon request, and (ii) duplicate the trust books and records (at such beneficiary’s expenses); provided, nothing herein shall require a trustee to disclose any beneficiary’s private and confidential information to another beneficiary without a court order.

F. Audit Demands

Trustees are facing audit requests more frequently. Thus, consideration should be given to confirming who is responsible for such cost. For example:

Any beneficiary may cause the books, records and accounts of any trust in which the beneficiary has a beneficial interest to be audited at any time, but the cost of the audit shall be paid by the beneficiary demanding it.

XIV. COMPENSATION & REIMBURSEMENT

A. Trustees Are Entitled To Compensation & Reimbursement Unless Prohibited

1. Compensation

The fees a trustee may charge should be considered when drafting the trust instrument. Unless the terms of the trust instrument provide otherwise, a trustee is entitled to reasonable compensation from the trust for acting as trustee. See Tex. Prop. Code Ann. § 114.061 (Vernon 2007). This is true even if the trust instrument does not mention compensation. See Id.; see also City of Austin v. Austin Nat. Bank, 488 S.W.2d 586 (Tex. Civ. App.—Austin 1972 writ granted), aff’d in part and rev’d in part on other grounds, 503 S.W.2d 759 (Tex. 1973)(trustee is entitled to be paid for his or
her work on behalf of trust estate). Section 114.061 provides as follows:

(a) Unless the terms of the trust provide otherwise and except as provided in Subsection (b) of this section, the trustee is entitled to reasonable compensation from the trust for acting as trustee.
(b) If the trustee commits a breach of trust, the court may in its discretion deny him all or part of his compensation.

TEX. PROP. CODE ANN. § 114.061 (Vernon 2007).

Thus, while a trustee is not permitted to profit individually in the course of trust transactions, this does not prohibit a trustee from being compensated for his, her or its services. And, compensation for services actually rendered does not make a trustee a beneficiary of a trust or disqualify him or her from serving as trustee. See McCauley v. Simmer, 336 S.W.2d 872 (Tex. Civ. App.—Houston [1st Dist] 1960, writ dism'd).

2. Reimbursement
Likewise, unless modified by the trust instrument, a trustee is entitled to reimbursement for:

(1) advances made for the convenience, benefit, or protection of the trust or its property;
(2) expenses incurred while administering or protecting the trust or because of the trustee's holding or owning any of the trust property; and
(3) expenses incurred for any action taken under Section 113.025.

TEX. PROP. CODE ANN. § 114.063 (Vernon 2007).

And, generally for torts committed in the administration of the trust when:

(1) the trustee was properly engaged in a business activity for the trust and the tort is a common incident of that kind of activity;
(2) the trustee was properly engaged in a business activity for the trust and neither the trustee nor an officer or employee of the trustee is guilty of actionable negligence or intentional misconduct in incurring the liability; or
(3) the tort increased the value of the trust property.

TEX. PROP. CODE ANN. § 114.062(b) (Vernon 2007); but see TEX. PROP. CODE ANN. § 114.062(c) (Vernon 2007) (“[a] trustee who is entitled to exoneration or reimbursement under Subdivision (3) of Subsection (a) is entitled to exoneration or reimbursement only to the extent of the increase in the value of the trust property”).

While a trustee’s attorneys’ fees and expenses appear to fall within the statutory provisions, many beneficiary-litigants will argue to the contrary. They instead insist that attorneys fees and expenses be awarded under Section 114.064, which provides:

In any proceeding under this code the court may make such award of costs and reasonable and necessary attorney's fees as may seem equitable and just.

TEX. PROP. CODE ANN. § 114.064 (Vernon 2007).

Thus, addressing the right to reimbursement of legal fees and expenses can be a prerequisite to the acceptance by some trustees.

B. What Is Reasonable Compensation?
What remains unclear is exactly how a trustee’s compensation should be determined and what is reasonable. Traditionally, a trustee has been compensated based on a percentage of the assets contained in the trust, and other factors such as the extent of the risk, the responsibilities of the trustee, the degree of difficulty in administering the trust, and the skill and success of the trustee. RESTATEMENT (SECOND) OF TRUSTS § 242 cmt. b.

But, what is reasonable to a trustee is often unreasonable to a beneficiary. Thus, it is generally preferable to provide some guidance in the trust instrument regarding the amount of contemplated compensation.

For example, the following provisions can lead to construction and disputes over the amount of a trustee’s compensation:

Each trustee shall be entitled to receive reasonable compensation and reimbursement of expenses for services actually rendered to a trust without regard to the provisions of any statute dealing with fiduciary compensation.

* * *
Any fiduciary is entitled to receive for services in that capacity reasonable compensation not exceeding the customary and usual compensation where the fiduciary services are performed. Any trustee is entitled to reimbursement for all expenses incurred in the administration of any trust.
estate, including, among other expenses, compensation to agents or fees for professional services.

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Each fiduciary shall be reimbursed from its estate for the reasonable costs and expenses incurred in connection with the administration of its estate and also shall be entitled to receive fair and reasonable compensation from its estate (payable at convenient intervals selected by the fiduciary) considering: (i) the duties, responsibilities, risks, and potential liabilities undertaken; (ii) the nature of its estate; (iii) the time and effort involved; and (iv) the customary and prevailing charges for services of a similar character at the time and at the place the services are performed.

C. Corporate Trustee Compensation

If the services of a corporate trustee are desired, either initially or in the future, compensation should be expressly addressed in the instrument. Most corporate trustees have set fee schedules and will only serve if they are entitled to compensation based on such fee schedules. For example:

Any corporate trustee shall receive payment for its services in accordance with its schedule of rates in effect at the time such compensation becomes payable, without reduction for any other fees or other compensation paid to the corporate trustee or any affiliated entity, including, but not limited to, such fees or other compensation paid by any mutual funds, unit investment trust or other investment vehicle, or an agent.

And if a corporate trustee may serve with other trustees, the corporate will generally expect to receive compensation at its rates without reduction for fees paid to any individual trustees. To avoid future issues, it is suggested that the trust instrument authorize such an arrangement. For example:

Where appropriate and customary, a bank or other corporate trustee may receive compensation in amounts not exceeding the customary and prevailing charges for services of a similar character at the time and at the place the services are performed as if it were serving as sole trustee.

D. Individual Trustee Compensation

The compensation of an individual trustee is perhaps the most difficult to address. Some instruments provide individual trustees must serve without compensation. Others only authorize independent individual trustees to receive compensation. For example:

Any trustee not related to Settlor by blood or marriage shall be entitled to receive reasonable compensation for services actually rendered to any trust created hereunder without regard to the provisions of any statute dealing with trustee compensation.

Others simply provide that the individual trustee is entitled to reasonable compensation. See discussion supra. Of course, a beneficiary’s idea of reasonable may be dramatically different than an individual trustee’s idea. While there is no perfect solution, one option is to authorize a per hour rate. For example:

Every fiduciary shall be reimbursed for the reasonable costs and expenses incurred in connection with such fiduciary’s duties. Every fiduciary [other than _______________] shall be entitled to fair and reasonable compensation for services rendered by such fiduciary in an amount not exceeding the customary and prevailing charges for services of a similar character at the time and place such services are performed; provided, however, if the trustee is an individual, his or her compensation shall not exceed $____ per hour (adjusted for inflation from the date of this trust).

Likewise, consideration should be given to whether an individual trustee should be authorized to engage him or herself to provide professional services. For example, an attorney or accountant may want to engage their firm to provide such services. Such arrangements often create concern and perhaps claims by beneficiaries that the fiduciary is self-dealing and has been paid excessive compensation. In general, both the fiduciary and the beneficiaries are better served by engaging independent professionals. But, if the settlor desires to sanction such an arrangement, it should be expressly authorized in the trust instrument. For example:

A professional individual serving as trustee may receive compensation for trustee services based on his or her customary hourly rates (or other customary charges for professional services). If the professional has hired himself or herself (or any professional organization with which he or
she is affiliated) in a professional capacity with respect to a trust, the trustee shall be entitled to compensation either for the professional services or the trustee services, but not both.

E. Authorize Waiver Of Trustee Compensation

It is also suggested that the trust agreement authorize the waiver of compensation. For example:

Any trustee may at any time waive a right to receive compensation for services rendered or to be rendered as trustee.

F. Address Foreseeable Non-Trustee Compensation

Some non-trustee compensation is reasonably foreseeable. For example, it is not uncommon for an individually trustee to engage an investment advisor. See discussion supra. If the instrument does not expressly authorize such compensation, the trustee may encounter issues regarding whether the trustee’s compensation should be reduced by the investment advisor’s fees.

And, if the settlor anticipates that any large or unusual employment arrangement will be needed in the administration of the trust, it is helpful if the employment arrangement is specifically authorized in the trust. It is likewise helpful if the compensation arrangement is authorized in the trust. For example, if the settlor desires that a particular investment advisor be used, with a particular fee arrangement, the trustee should be authorized to employ that investment advisor and pay the compensation to which the settlor has agreed. This can avoid having trust beneficiaries question the propriety of the employment of the agent and the compensation that is paid.

G. Can Settler Override Statutory Review Of Compensation?

In short, not when the trustee commits a breach of trust. Texas Trust Code Section 111.0035 provides that the terms of a trust cannot limit a court’s power, “in the interest of justice, to take action or exercise jurisdiction, including the power to . . . [a]djust or deny a trustee’s compensation if the trustee commits a breach of trust.” TEX. PROP. CODE ANN. § 111.0035(b)(5)(E) (Vernon 2007). Thus, if a trustee commits a breach of trust, the court may in its discretion deny the trustee all or part of his or her compensation. See TEX. PROP. CODE ANN. § 114.061(b) (Vernon 2007). For example, compensation has been refused where the trustee failed to use ordinary care in the administration of trust, failed to keep proper records of trust administration, failed to invest trust property, mingled trust property with his or her own, or was guilty of disloyalty to beneficiaries by acting for his or her own selfish interests. Langford v. Shamburger, 417 S.W.2d 438 (Tex. Civ. App.—Fort Worth 1967, writ ref'd n.r.e.), disapproved of on other grounds by Texas Commerce Bank, N.A. v. Grizzle, 96 S.W.3d 240, (Tex. 2002).

XV. EXONERATION & INDEMNITY

A. Overview Of The General Duties of a Trustee

A trust involves a fiduciary relationship. William F. Frathcer, Scott on Trusts § 348 (4th Ed. 1989). But, just as there is no single correct definition of what constitutes a fiduciary relationship, there are no hard and fast rules defining the duties of a trustee, and, to a great extent, the duties may overlap considerably. Just what is expected of a “fiduciary” may have been best summarized by Justice Cardozo in the case of Meinhard v. Salmon, 249 N.Y. 458, 164 N.E. 545-546, 62 A.L.R. 1 (1928):

Many forms of conduct permissible in a workaday world for those acting at arms length are forbidden to those bound by fiduciary ties. A [fiduciary] is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the “disintegrating erosion” of particular exceptions. . . . Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd.

See also Langford v. Shamburger, 417 S.W.2d 438 (Tex.Civ.App. – Fort Worth 1967, writ ref’d n.r.e.).

In addition, certain types of fiduciaries (such as trustees) have special duties defined by the trust instrument and additional statutory duties that may alter or negate some fiduciary duties otherwise imposed by Texas “common law.” The Texas Trust Code instructs that “[t]he trustee shall administer the trust in good faith according to its terms and [the Texas Trust Code] . . . and shall perform all the duties imposed on trustees by the common law.” TEX. PROP. CODE ANN. § 113.051 (Vernon 2007).

Generally speaking, the duties of a fiduciary may be roughly categorized under four main headings:

- The duty of competence;
- The duty to reasonably exercise discretion;
- The duty of loyalty; and
The duty to make full disclosure of material facts.

B. Defining Standards of Conduct

Exoneration provisions are often based on standards of conduct: good faith, bad faith, reckless indifference, etc. It is important to be familiar with how courts will construe such terms when drafting these provisions.

1. Bad Faith.


2. Good Faith.

Texas recognizes a standard of good faith that combines subjective and objective tests. See Lee v. Lee, 47 S.W.2d 767, 795 (Tex.App.—Houston [14th Dist.] 2001, pet. denied). A fiduciary acts in good faith when he or she: (1) subjectively believes his or her defense is viable, and (2) is reasonable in light of existing law. Id.


Gross negligence means more than momentary thoughtlessness, inadvertence, or error of judgment; it means such an entire want of care as to establish that the act or omission was the result of actual conscious indifference to the rights, safety, or welfare of the person affected. See Transp. Ins. Co. v. Moriel, 879 S.W.2d 10, 20 (Tex. 1994). An act or omission that is merely thoughtless, careless, or not inordinately risky cannot be grossly negligent. Id. at 22. Only if the defendant’s act or omission is unjustifiable and likely to cause serious harm can it be grossly negligent. Id. Although gross negligence does refer to a different character of conduct than ordinary negligence, a party’s conduct cannot be grossly negligent without being negligent. See Trevino v. Lightning Laydown, Inc., 782 S.W.2d 946, 949 (Tex.App.—Austin 1990, writ denied). Gross negligence involves proof of two elements:

- Viewed objectively from the actor’s standpoint, the act or omission must involve an extreme degree of risk, considering the probability and magnitude of the potential harm to others. “Extreme risk” is not a remote possibility of injury or even a high probability of minor harm, but rather the likelihood of serious injury to the plaintiff; and,
- The actor must have actual, subjective awareness of the risk involved, but nevertheless proceed in conscious indifference to the rights, safety, or welfare of others. Ordinary negligence rises to the level of gross negligence when it can be shown that the defendant was aware of the danger but his acts or omissions demonstrated that he did not care to address it. See TEX. CIV. & REM. CODE ANN. § 41.001(11) (Vernon 1997 & Supp. 2009); Louisiana-Pacific Corp. v. Andrade, 19 S.W.3d 245, 246-47 (Tex. 1999). See Mobil Oil Corp. v. Ellender, 968 S.W.2d 917, 921 (Tex. 1998) (citing Moriel, 879 S.W.2d at 23 (Tex. 1994)).

C. Liability For Acts of Cotrustees

Unless the instrument provides otherwise, Texas Trust Code Section 114.006 addresses when a cotrustee is liable for the acts of other cotrustees. Section 114.006 provides that:

(a) A trustee who does not join in an action of a cotrustee is not liable for the cotrustee's action, unless the trustee does not exercise reasonable care as provided by Subsection (b).

(b) Each trustee shall exercise reasonable care to:

(1) prevent a cotrustee from committing a serious breach of trust; and

(2) compel a cotrustee to redress a serious breach of trust.

(c) Subject to Subsection (b), a dissenting trustee who joins in an action at the direction of the majority of the trustees and who has notified any cotrustee of the dissent in writing at or before the time of the action is not liable for the action.


D. Understanding Who Has The Burden of Proof at Trial

It is also beneficial to understand who will have the burden to prove or disprove a claim in a lawsuit. This may impact the level of exoneration or indemnity given to a trustee or other fiduciary

3. Complainant’s Burden.

The complainant has the burden at trial to prove a trustee breached the following duties:

- Duty of competence; and
• Duty to reasonably exercise discretion.

With regard to these duties, fiduciary law does not require absolute perfection in judgment.

4. Trustee’s Burden.
   The trustee has the burden at trial to prove the trustee did not breach the following duties:
   • Duty of loyalty; and
   • Duty of full disclosure.

With regard to these duties, fiduciary law requires absolute perfection in loyalty and honesty.

E. Why Include An Exculpation or Indemnity Provision?
   As with every aspect of trust administration, exculpation provisions provide a potential or actual trustee with some level of comfort to exercise his, her or its discretion. By providing an appropriate level of exculpation, a trustee is encouraged to accept the trust, even with foreseeably difficult beneficiaries, and also creates a disincentive to a beneficiary seeking to threaten a trustee into making a distribution. And, Texas generally upholds these provisions, except to those matters statutorily excluded. See TEX. PROP. CODE ANN. § 114.007 (Vernon 2007).

Thus, an exculpation provisions may exonerate the trustee for acts other than those for which liability cannot be cannot be exculpated. For example:

This instrument shall always be construed in favor of the validity of any action or inaction by any trustee, and a trustee shall not be liable for any action or inaction except in the case of a breach of trust committed in bad faith, intentionally; or with reckless indifference to the interest of a beneficiary.

Or an exculpation provision can stipulate other exclusions from exculpation. But, these provisions should be carefully drafted because an exception from exculpation can lead to unintended consequence. For example, a trustee’s failure to disclose can be tantamount to fraud.

F. Limits On Exculpation or Indemnity Provisions
   Texas Trust Code Section 114.007 provides that a settlor may exculpate a trustee from liability other than for:
   (1) a breach of trust committed:
       (A) in bad faith;
       (B) intentionally; or
       (C) with reckless indifference to the interest of a beneficiary; or
   (2) any profit derived by the trustee from a breach of trust.

   TEX. PROP. CODE ANN. § 114.007 (Vernon 2007).
   Additionally, some settlors provide that an uncompensated trustee, either by choice or by instrument, shall be entitled to a higher level of exoneration than a compensated trustee. The question is whether this creates the best incentives for the trustee and even the best protection for the beneficiary?

G. Sample Provisions
   These clauses are usually strictly construed. Therefore, the failure to draft clear exoneration, indemnification, duty to defend, and hold harmless clauses can result in limited protection and unanticipated liability.

1. Trustee.
   An example of an exoneration and indemnity of a trustee for possible claims by “disappointed” beneficiaries follows:

   My trustee shall not be liable for any loss or depreciation in value of my properties, except any loss attributable to a breach of trust committed in bad faith, intentionally; or with reckless indifference to the interest of a beneficiary, and my trustee shall not be accountable or held liable for any act or omission if my trustee has used good faith and ordinary care in the exercise of his powers.

   A more copious provision suggested by Frank Ikard in his outline, Exclupatory Claims and Their Effectiveness To Protect Drafts and Fiduciaries, is as follows:

   Notwithstanding anything to the contrary herein, my Fiduciary shall, to the greatest extent permitted by Texas law at the time this clause is construed, be exculpated from any liability whatsoever for any alleged abuse of discretion, tort, breach of fiduciary duty and/or breach of trust caused by any act or omission in the administration of my estate or any trust created under my Will. As a consequence, no person, firm or corporation ever serving as my Fiduciary shall ever be held personally liable to any other person, firm or corporation for any damages directly or indirectly arising out of any act or omission committed in the administration of my estate or in the administration of any trust created under my Will. This exculpation shall not, however, protect my Fiduciary from any liability for self dealing, bad faith, acts which
are intentionally adverse to a Distributee or acts of reckless indifference toward the interest of a Distributee. Even if this exculpation clause shall not protect my Fiduciary because of the foregoing sentence, in no event shall my Fiduciary ever be liable for any punitive or exemplary damages for any act or omission committed in the administration of my estate or in the administration of any trust created under my Will regardless of whether such act or omission constituted gross negligence, self dealing, bad faith, reckless indifference to my Distributees or intentional harm to my Distributees. This provision shall survive the administration of my estate and shall expressly apply to the administration of any trust created in this Will.


2. Third Parties.
An example of an indemnity of third parties relying on a trustee’s authority is as follows:

“I hereby INDEMNIFY, DEFEND, and HOLD HARMLESS any third party for any claims, costs or expenses, including attorneys fees and expenses, that arise against or are incurred by such third party because of such party’s reliance upon this trust instrument at any time prior to the date such party receives actual notice of the revocation of this trust instrument.”

XVI. TRUST PROTECTORS AND ADVISORS
A. What Is A Trust Protector and/or Advisor?
The enactment of Section 114.003 appeared to recognize and validate the appointment of trust protectors or advisors. Section 114.003(a) provides that “[t]he terms of a trust may give a trustee or other person a power to direct the modification or termination of the trust. TEX. PROP. CODE ANN. § 114.003(a) (Vernon 2007). And, Section 114.003(b) essentially confirms that a trustee generally must act in accordance with a protector or advisor’s directions unless

(1) the direction is manifestly contrary to the terms of the trust; or
(2) the trustee knows the direction would constitute a serious breach of a fiduciary duty that the person holding the power to direct owes to the beneficiaries of the trust.

TEX. PROP. CODE ANN. § 114.003(b) (Vernon 2007).

Although leaving the role of the trust protector and advisor generally ill defined, the Texas Trust Code does now state that they are “presumptively a fiduciary.” TEX. PROP. CODE ANN. § 114.003 (Vernon 2007).

While still somewhat uncertain and imprecise, the use of trust protectors and advisors in domestic trusts has increased over the last few years. Clients now often appoint one or more trust protectors or advisors and grant them the authority to modify a trust or limit their authority to make certain modification. Also, the trust protector or advisor can be used to appoint a trustee, remove a trustee, ratify decisions of the trust, terminate a trust, move a trust to another jurisdiction, or even insulate a trustee from liability.

Because of the flexibility they can provide, consideration should be given to appointing a trustee protector or advisor for the trust. And, as with trustees, the instrument should both name trustee protector or advisor and plan for any successors. For example:

There shall be a Trust Protector of each trust created by or pursuant to this instrument. We appoint the following as sole Trust Protector of every trust created under this instrument: ______, otherwise ______. If all of the above (and any successors) fail or cease to serve as Trust Protector of any trust, and if a successor Trust Protector has not been appointed as provided in Section ___, the trustee of that trust shall appoint a Trust Protector of that trust in accordance with the provisions of Section ____.”

But, because the role of the trust protector or advisor remains so ill defined in Texas, there are no default provisions that apply. Thus, the instrument should clearly provide for the appointment, resignation, powers and rights of the trust protector or advisor. A sample provision may include the following:

The provisions of this Article govern the office of the Trust Protector. When used in this instrument, where the context permits, the term Protector means the Trust Protector or Co-Protectors from time to time serving and the "estate" of the Trust Protector means the particular trust estate being protected by the Trust Protector.

a). Protector Appointment Authority. The Trust Protector shall have the power to appoint additional Trust Protectors and a successor or successors to any Protector hereof. Any such appointment may be changed by the Trust Protector from time to time prior to the time it becomes effective. If a Trust Protector resigns
or otherwise ceases to act as such and there is at least one other Protector then acting as such, then the remaining Protector or Protectors shall continue to act. If a sole Protector resigns or otherwise ceases to act as Trust Protector of any trust and a successor Trust Protector for that trust has not been appointed in accordance with the preceding provisions of this Section, then the trustee of that trust, within ninety (90) days from the date the Trust Protector resigns or otherwise ceases to act, shall appoint a successor Trust Protector, but may not appoint itself or any related or subordinate party, as described in Code Section 672(c), to itself as Trust Protector. The failure of the trustee to appoint a successor Trust Protector within such ninety (90) day period shall not be considered to be a waiver of the trustee's duty to appoint a successor Trust Protector.

b). Protector Appointment Procedures.

i). Generally. Any appointment of a successor or additional Trust Protector shall be by a written instrument delivered to the trustee of the trust, and to the appointee and shall be effective at the time or under the conditions specified in such instrument (but in no event shall such appointment be effective prior to the time that the trustee receives actual notice of such appointment) and shall be attached to this instrument.

ii). Qualified Individual Or Entity. In deciding who to appoint as a successor or additional Trust Protector, the Trust Protector or trustee, as the case may be, should determine that the individual or entity has the requisite experience, expertise, and education to discharge the office of Trust Protector in accordance with the terms of this instrument. Additionally, that individual or entity should be willing and able to commit the time and resources necessary (a) to know and understand the personal situation of each beneficiary and his or her economic and financial circumstances to the extent necessary to act on behalf of each beneficiary and (b) to take the actions required to protect each beneficiary in a meaningful way. Provided, however, no Trust Protector of any trust created by or pursuant to this instrument shall be any of the following: (i) either one of us, (ii) the beneficiary of any trust created under this instrument, or (iii) any individual or entity who, during our lifetimes, is related or subordinate to either one of us within the meaning of Code Section 672(c) or any individual or entity that is otherwise related or subordinate to either one of us.

c). Protector Incapacity. If any Protector (i) become incapacitated, (ii) becomes subject to any bankruptcy laws; or (iii) if the Trust Protector is a company or other entity and (a) enters into liquidation, whether compulsory or voluntary, provided that such liquidation is not merely a voluntary liquidation for the purposes of amalgamation or reconstruction, (b) enters into receivership, (c) has an administrator of the Trust Protector appointed, or (d) becomes subject to any bankruptcy laws (or being in any analogous state or subject to any analogous action in any jurisdiction), such Protector shall thereupon be deemed to have resigned as Trust Protector, and the appointment of a successor Trust Protector shall be governed by this Article.

d). Protector Resignation. A Trust Protector may resign as Trust Protector of any one or more trusts created under this instrument at any time, with or without cause, by delivering a resignation notice in recordable form to the trustee. Any resignation of a Trust Protector shall take effect upon the receipt of the written notice by the trustee and shall be attached to this instrument.

e). Consent Of Trust Protector. Any provision of this instrument which requires the consent of the Trust Protector shall require the Trust Protector's written consent. Furthermore, failure by a Trust Protector to give any such consent or make any decision or to communicate with the trustee regarding any such consent or decision shall be deemed for all purposes as a refusal to consent and shall be treated by the trustee as a refusal to consent.

f). Death Of Trust Protector. The duties and powers of the Trust Protector shall be personal and shall cease upon the death of the person holding such office (if an individual) or upon the dissolution of the entity acting as Trust Protector (in the case of a corporation or other entity acting as Trust Protector). The powers of the Trust Protector shall not be capable of being delegated or of being exercised by any representative (whether a personal representative or otherwise), agent, receiver, or liquidator of the Trust Protector.

g). Administrative Authority. Without regard to any other provisions of this instrument, the Trust Protector shall have the following administrative powers that are exercisable from time to time and at any time.
B. Using Trust Protector and/or Advisor To Appoint And Remove Trustees
At a minimum, a trust protector or advisor is a useful tool to fill a vacant office of trustee or even remove a trustee. See also discussion supra. For example:

I appoint the following, in the following order, as sole Trustee of every trust created under this Will: ______, otherwise ______, otherwise ______. If all of the above (and any successors) fail or cease to serve as Trustee of any trust and the resulting vacancy is not filled under the provisions of Section ____, the Trustee Protector (designated in Section ___) shall appoint a trustee of that trust in accordance with the provisions of Section ____.

C. Using Trust Protector and/or Advisor To Demand Accounting
And, the trust protector or advisor can be given the power to demand an accounting. For example:

Without regard to any other provision of this instrument, the Trust Protector shall have the power, exercisable at any time, and from time to time, to demand an accounting by the trustee, setting forth the receipts, disbursements, and distributions of both principal and income during the period of accounting and the invested and uninvested principal and undistributed income that is in existence at the beginning and at the end of such accounting period.

D. Using Trust Protector and/or Advisor To Demand Bond
As a means to protect the beneficiaries, the trust protector or advisor could be given the power to demand bond. For example:

Without regard to any other provision of this instrument, the Trust Protector shall have the power, exercisable at any time, and from time to time, to require in writing that the trustee, or any person or entity to whom the trustee has delegated a power pursuant to any provision of this instrument, be required to give a bond or other security for the faithful administration of its or their duties under this instrument.

E. Using Trust Protector and/or Advisor To Designate Governing Law
Likewise, giving the trust protector or advisor rather than the trustee the right to designate the trust governing law may balance the interests of the trustee and the beneficiaries. For example:

Without regard to the provisions of Section _____, the Trust Protector shall have the power exercisable at any time, and from time to time, to designate the law of any jurisdiction (under which the terms of any trust created by or pursuant to this instrument shall be capable of taking effect) to be the governing law of any trust created by or pursuant to this instrument, and to declare that such trust shall thereafter be governed by and take effect according to the laws of the jurisdiction so designated. The Trust Protector shall also have the power to declare that the courts of such jurisdiction may or shall become the forum for the administration of such trust. Such a designation and declaration shall be set forth in an acknowledged written instrument which shall contain the powers and provisions which are necessary to enable such trust to be capable of taking effect under the laws of such jurisdiction (including, but not limited to, any applicable rule against perpetuities), and which may also contain such other powers and provisions as the Trust Protector may determine to be in the best interest of the beneficiaries. Upon the declaration by the Trust Protector that the Trust or any trust established by or pursuant to this instrument shall be governed by the laws of a new jurisdiction, the rights of all persons, parties, and entities, and the construction and effect of each and every provision of the trust shall be subject to and construed only according to the laws of the designated jurisdiction.

F. Protect the Trust Protector and/or Advisor
Even thought it is being used with increasing frequency, the role of a trust protector or advisor remains ill defined or understood in Texas. But, effective January 1, 2006, it appears that a trust protector or advisor is presumptively a fiduciary pursuant to Texas Trust Code Section 114.003, which provides as follows:

A person, other than a beneficiary, who holds a power to direct is presumptively a fiduciary required to act in good faith with regard to the purposes of the trust and the interests of the beneficiaries. The holder of a power to direct is liable for any loss that results from a breach of the person's fiduciary duty.
Thus, consideration should be given how to reduce the trust protector or advisor’s duties, liabilities and obligations to entice them to serve in this vital role.

If the trust protector or advisor is given limited rights and responsibilities, consideration should be given to granting the trust protector or advisor broader exoneration than the trustee. For example, the agreement may provide:

The Trust Protector shall have absolutely no duty whatsoever to act or not to act with respect to any activity or action that the Trust Protector is empowered to undertake hereunder and the Trust Protector shall not be liable for so acting or not acting. The Trust Protector shall also have no duty whatsoever to consent or not to consent to any activity or action that the trustee is empowered to undertake hereunder with the consent of the Trust Protector, and the Trust Protector shall also not be liable for so consenting or failing to consent.

Also, any exoneration, indemnity, and arbitration provisions should expressly include protectors. For example:

The Trust Protector shall have the benefit of all the indemnities, protections, and excusations as conferred on the trustee by the operation of law and under the terms of this instrument.

XVII. NO CONTEST & INTERFERENCE CLAUSES
Most estate planning lawyers are generally familiar with the use of no contest clauses in wills. Less often, no contest clauses have been used effectively to avoid disputes involving the dispositive provisions of a trust. A no contest clause does not, however, need to be limited to dispositive provisions of an instrument. Rather, Texas law recognizes that no contest provisions can be drafted as broadly or narrowly as the testator or settlor deems appropriate. Provided the no contest clause is specific and direct in its intent, Texas courts will often enforce these provisions. Furthermore, the testator or settlor can provide that a beneficiary’s interest shall be void even if the challenge is made in good faith.

Therefore, a client may consider using a no contest provision to avoid unreasonable interference with the trust administration. Furthermore, a no contest provision should be drafted in a manner that balances the interest of the client to avoid interference but still allows beneficiaries to voice valid complaints should a trustee attempt to use the no contest provision as a sword instead of a shield.

XVIII. ATTORNEY FEE AND EXPENSES ALLOCATION CLAUSES.
Similar to debt and tax allocation clauses, it is important to consider how legal fees and expenses should be allocated between and among beneficiaries. The instruments should address whom and under what circumstances such fees and expenses will be allocated against a particular beneficiary’s share or interest. The instrument may also limit the circumstances when a beneficiary can seek reimbursement for his or her legal fees. See Donaho, OFFENSIVE AND DEFENSIVE ESTATE PLANNING, State Bar of Texas 25th Annual Estate Planning and Probate Course (2001).

This is particularly important when a pot trust is utilized. For example, if a beneficiary unsuccessfully sues a trustee in an attempt to increase his or her distributions, the trustee may be authorized to offset all the defenses costs against the beneficiary’s current distributions or future share, when the trust terminates. Of course, these provisions should not be drafted in such an onerous manner that the beneficiary has no recourse against a rogue trustee.

Frank Ikard’s outline on exculpatory clauses provides the following example:

My Fiduciary shall have the right and power, without prior Court approval, to obtain reimbursement from the property of my estate (or, if applicable, the trust estate of any trust created under my Will) for all expenses and costs (including, without limitation, reasonable attorney’s fees and expenses) incurred by my Fiduciary in connection with his defense of or participation in any form of fiduciary litigation. This right of reimbursement shall be binding on all Distributees, regardless of the nature of the claims brought against my Fiduciary, regardless of the plaintiff’s good faith or probable right of recovery, and regardless of my Fiduciary’s ability to pay such amounts from his own resources or to satisfy a judgment for such amounts; provided, however, this right of reimbursement shall not limit any Distributee’s right to recover, either from my Fiduciary individually or on behalf of my estate or the trust estate of any trust created under my Will, any amounts used to reimburse any Fiduciary if any cause of action is reduced to a final and non appealable judgment against my fiduciary. This provision shall survive the administration of my estate and shall expressly
apply to the administration of any trust created in this Will.

Ikard, EXCLUDATORY CLAIMS AND THEIR EFFECTIVENESS TO PROTECT DRAFTS AND FIDUCIARIES, State Bar of Texas 18TH ADV. ESTATE PLANNING & PROBATE COURSE (1994).

XIX. DISPUTE RESOLUTION PROVISIONS 
& INCENTIVES

A. Overview
To say that litigation can be costly is an understatement. When a trust becomes embroiled in litigation, the parties can incur fees and expenses in the hundreds of thousands of dollars. While not all litigation is avoidable, some preplanning can sometimes provide ways to plan for it and perhaps reduce the expense. Whether the issue is lack of communication or matters far worse, the following provisions should be considered as tools to plan for and potentially reduce future disputes.

B. Disputes Between Trustees
Just as beneficiaries can have differences with trustees, trustees can have disputes between themselves. This is particularly problematic when two trustees are serving as it generally results in a deadlock. Thus, consideration should be given to including a trustee dispute resolution clause. For example:

If, after consultation with each other, my cotrustees are unable to agree regarding any matter affecting the administration or management of any trust that is not specifically subject to the sole discretion of one or more cotrustees, the decision of a majority of the trustees then serving shall govern. Any dissenting cotrustee may file a written dissent to the action proposed or taken, and such dissenting cotrustee shall have no liability with respect to any actions taken or not taken over the written dissent of such cotrustee. If only two (2) trustees are serving as such, any unresolvable dispute shall be decided solely by a binding arbitration.

C. Disputes Between Trustees & Beneficiaries
1. Require Notice of Complaints and Time to Cure
At a minimum, it is advisable to include a provision that requires any person complaining of a trustee’s action, to provide the fiduciary written notice of the alleged issue or claim. The document should also provide a reasonable time to cure. For example, to avoid a rush to the courthouse, a beneficiary may be required to notify a trustee of any alleged complaints regarding trust distributions prior to filing a lawsuit. Such notice could be made a condition precedent to seeking legal fees and expenses for the alleged breach.

Of course exceptions should be made if immediate action is required due to imminent danger to the trust. As with all notices, the document should provide how the notice should be given, the matters that should be contained in the notice, and the means of notification, i.e., certified mail, facsimile, etc.

2. Include Pre-Suit Mediation Requirement
Many disputes are the result of lack of communication and frustration. Just as mediation often results in the initial resolution of a lawsuit, so may it resolve issues prior to a lawsuit in a cost effective manner. For example, the Texas Real Estate Association’s standard residential real estate sales contract now provides that the parties to it agree to attend mediation in the even of any dispute.

This same provision can be utilized with regard to trusts. The trust instrument may provide that in the event a dispute arises between or among any of the fiduciaries and/or the beneficiaries relating to the administration of the estate or trust, they agree to attend mediation and attempt to resolve such disputes before initiating other legal action. Such attendance could be made a condition precedent to the right to seek legal fees and expenses in a related lawsuit.

There should also be a stipulated time frame in which the complained of parties agree to attend mediation or their right to enforce such a provision will be deemed waived. Also, to avoid an argument regarding who is required to pay for mediation, the document should address how the parties will pay for mediation: equally or agree that mediator or third party will have the power to assess costs as between the parties or against the trust, as the circumstances warrant.

3. Consider Including An Arbitration Provision
Arbitration continues to provide parties an alternative forum in which to settle disputes and often avoids unwanted publicity or disclosures associated with a public proceeding. To be binding, parties must contractually agree to submit their disputes to arbitration in lieu of, or in addition to, other remedies available under Texas law.

In the past decade, arbitration procedures have been routinely included in agreements involving business associations such as partnerships, employment, purchase and sale, and professional services agreements. While there is no Texas law specifically addressing an arbitration clause in a trust instrument, it is generally believed that a settlor and trustee may agree to the inclusion of a binding arbitration provision in a trust instrument. By creating a trust instrument, a
settlor is bound by all of its terms, including the arbitration clause. Furthermore, by accepting appointment as trustee, the trustee effectively agrees to be bound by all agreements set forth in the trust instrument, including the arbitration clause.

An argument can also be made that a trust beneficiary is bound by the arbitration clause as he or she takes his or her interest subject to all of the terms and conditions of the trust, including the arbitration provision. To give the trustee some further protection, the trust instrument can provide that by entering into arbitration or mediation of a dispute, the trustee will not have engaged in a breach of fiduciary duty or duty of loyalty as some beneficiaries have raised the argument that by asserting its right to an alternate form of dispute resolution, the trustee has put its interest above that of a beneficiary.

Disputes relating to distributions are among the matters that the settlor may require be submitted to arbitration. The settlor of a trust has the ability to fashion arbitration provision as he or she chooses, as there are no specific requirements with regard to submitting disputes to arbitration. If arbitration is desired, the arbitration provision should expressly address the matters that may be submitted to arbitration, the process of arbitration, who shall pay the fees of arbitration, and whether there are any specific requirements as to the proposed arbitrators, such as board certified lawyers, financial advisors, accountants, etc., and that the decision will be binding on future beneficiaries of the trust or provide for virtual representation in the arbitration setting.

4. Consider A Provision That Waives The Right to Jury Trial on Disputed Issues

If arbitration is not selected, another alternative to reduce future litigation costs may be to attempt to require all beneficiaries to agree to waive his or her right to seek a jury trial on any issues relating to the trust. While there is no Texas case that has addressed this in the context of a trust instrument, the Texas Supreme Court has recently upheld such a provision in a commercial contract. See In re The Prudential Insurance Co. of America and Four Partners L.L.C., 148 S.W.3d 124 (Tex. 2004); see also In re General Elec. Capital Corp. 148 S.W.3d 124 (Tex. 2006)(trial court abused its discretion in refusing to enforce jury waiver because contractual provision was not proven to be invalid or impliedly waived by the knowing conduct of the party seeking to enforce it).

In Prudential, the Texas Supreme Court considered the issue of whether a lease provision waiving a jury in any litigation over the lease is by itself unenforceable and, if not, whether the provision is invalid in a lease. In Prudential, the underlying lawsuit involved a restaurant company's lease with Prudential's agent and the restaurant owner's guaranty that incorporated provisions of the lease by reference. The restaurant company and the owners sued to end the lease because of an allegedly foul odor on the premises and requested a jury trial. Prudential moved to quash their jury demand, but the trial court denied the motion. The court of appeals then denied mandamus relief. Reversing the lower courts, the Texas Supreme Court held that a jury trial-waiver clause in an agreement does not violate Texas law or public policy. Rather, public policy that permits parties to waive trial altogether does not forbid waiver of trial by jury. Thus, if the parties willingly agree to a non-jury trial, enforcing that agreement is preferable to leaving them with arbitration as their only enforceable option because in arbitration parties waive not only their right to trial by jury but their right to appeal. See Id.

XX. CONCLUSION

As the foregoing discussion illustrates, there are a number of matters that should be considered when drafting fiduciary provisions. As with disposition and tax provisions, the duties, powers and protection of the fiduciaries under the trust agreement may vary with the client's specific facts and circumstances. The success of the client's plan will hinge, in part, on these fiduciary provisions. Hopefully, the proceeding discussion provides some food for thought regarding recognizing and avoiding some of the more common issues.