

**EXCULPATORY CLAUSES AND
THEIR EFFECTIVENESS TO PROTECT DRAFTERS AND FIDUCIARIES**

(SUGGESTIONS FOR DRAFTING NEEDED CLAUSES IN WILLS AND TRUSTS
TO AVOID OR MINIMIZE POTENTIAL LIABILITY
IN FIDUCIARY LITIGATION)

By

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STATE BAR OF TEXAS
18TH ANNUAL ADVANCED ESTATE PLANNING AND PROBATE COURSE

June 1994

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PRELIMINARIES

Introduction

My discussion of clauses to protect the fiduciary is divided into three parts. They are "General Drafting Considerations," "Fiduciary Protection Clauses" and "Concept Clauses."

General Drafting Considerations relate to the purpose of the fiduciary relationship and the powers and duties of the fiduciary. Careful thought in drafting clauses may eliminate the potential for fiduciary litigation by clearly defining the processes by which the fiduciary makes discretionary decisions and by informing the distributees of the purposes for the creation of the fiduciary relationship. These considerations should be a part of the process of drafting every will and trust.

Fiduciary Protection Clauses are the clauses that expressly relieve a fiduciary from fiduciary liability or inhibit a distributee's ability to prosecute fiduciary litigation. These clauses sacrifice rights of the distributees for the purpose of protecting the fiduciary from liability. These clauses should never be a part of the "boilerplate" language in a legal instrument. They should, however, be considered when there is a known risk of fiduciary litigation or when the person

D. Fiduciary Litigation shall refer to any legal proceeding appertaining to the administration of an estate or the administration of any trust created under a will in which a fiduciary is a party, in either his individual or representative capacity, or to

creating the fiduciary relationship has a special relation with the fiduciary.

Concept Clauses are clauses that are solely a product of this author's imagination. They address issues that are frequently confronted in the fiduciary litigation process. They have not, for the most part, ever been approved or addressed by a Texas court and should be used with extreme caution, if at all.

Definitions.

The following words, when used in this paper have the following meanings:

- A. Fiduciary shall refer to any personal representative of an estate, to any trustee of any trust created under a will, or to any other person, firm or corporation given fiduciary powers or duties under a will.
- B. Distributee shall refer to any distributee under a will as well as any beneficiary of any trust.
- C. Fiduciary Attorney shall refer to the attorney or law firm representing a fiduciary in connection with the administration of any estate or any trust.

any other legal proceeding where a fiduciary opposes any position taken or asserted by any distributee (including any action to remove a fiduciary, to surcharge him, to compel him to perform or refrain from performing any act, to enjoin him in any way, to construe any

provision of a will, to seek any form of declaratory relief, to demand any form of accounting or to contest any accounting that he has prepared or filed).

I.

GENERAL DRAFTING CONSIDERATIONS

A. Definition of Fiduciary Duties.

Most of the statutory and common law fiduciary duties may be either modified or revoked by the person creating the fiduciary relationship. Any draftsman should carefully select and define the powers and duties applicable to each fiduciary. Particular attention should be given to the duties of prudence, loyalty and impartiality.

The common law and statutory powers and duties are usually not adequate to provide for the specific needs of a client. More importantly, most trustees and beneficiaries are not familiar with either the statutory or common law fiduciary duties. If the duties are specifically spelled out in the instrument, then both the trustee and the beneficiaries will be able to at least read the instrument and have a basic understanding of what the trustee is authorized to do. Most fiduciary litigation involves alleged breaches of the fiduciary duties of prudence, loyalty or impartiality. Special attention should be given to these duties.

In a will the executor will usually be given both the powers and the duties of the trustee. There is, however, some difference of opinion on this subject. Some commentators believe that because the executor's job is only to administer the decedent's estate as rapidly as possible, the executor should not be given the powers of

the trustee. The existence of such powers may delay the closing of the administration of the estate. Thought should be given to the extent the executor is authorized and/or instructed to make distributions to trust beneficiaries during the administration of the decedent's estate.

If special assets are involved then consideration should be given to modifying the duty of prudence to provide specifically for the retention, management and reinvestment of these assets. Examples of this type of assets are: closely held corporate stock, a family homestead, a family farm, a weekend resort residence.

Special concern should be given to the ability of the fiduciary to retain unproductive assets (a lesser included element of the duty of prudence). The court in *Neuhaus v. Richards*, 846 S.W.2d 70 (Tex.Civ.App.--Corpus Christi 1992, no writ) noted that "though Texas courts have not addressed this particular issue, courts in other states have specifically restricted the extent to which the settlor may limit the trustee's liability for failure to sell unproductive trust investments. Those courts have held that the trust instrument may relieve the trustee of the duty to act as a prudent man in determining to retain unproductive property, but not of the duty to do so honestly, in good faith, and without willful misconduct or reckless indifference to the interests of the beneficiaries." See *Stark v. United States Trust Co.*, 445 F.Supp. 670, 683 (S.D.N.Y., 1978); *Perling v. Citizens and Southern National Bank*, 250 Ga. 674, 300 S.E. 649, 653 (Ga.1983); *Hoffman v. First Virginia Bank*, 220 Va. 834, 263 S.E.2d 402, 407-408 (Va. 1980); 90 C.J.S. Trusts @331 (1955). In other words, the trustee's determination to retain unproductive investments is generally protected as long as that determination was not made dishonestly, in bad faith, recklessly or with the intent to harm the trust.

If a fiduciary has a special relationship to the person appointing the fiduciary (*i.e.* such person is a spouse, close friend or close relative) then exculpation should be considered. This is especially true if the As many prohibited transactions as possible should be specifically set forth in the instrument. If they are, then the beneficiary will know, for example, that he or she may not borrow from the trust; at least not without the necessity of having several attorneys render legal opinions on the matter.

The duty of impartiality should be carefully considered, and it is usually advisable to at least partially waive this duty. Thought should be given to whether members of the same class of distributees must be treated equally; whether members of one class should be given priority over members of another class; whether income beneficiaries should be given priority over remaindermen; and whether living beneficiaries should be given priority over unborn or unknown beneficiaries.

The duty to investigate the acts and omissions of predecessor fiduciaries should also be given careful consideration. If the duty is waived then consideration should be given to the situation where the fiduciary learns, without any investigation, of a prior fiduciary's breach of fiduciary duty.

There is no provision in the Texas Probate Code expressly allowing a testator to revoke or modify any fiduciary duty. Texas common law, however, clearly allows for a testator to relieve a personal representative from certain fiduciary duties. There are specific provisions in the Trust Code allowing a trustor to relieve a trustee from fiduciary duties.

Texas Trust Code Section 113.051 provides that:

The trustee shall administer the trust according to its terms and this subtitle. In the absence of any contrary terms in the

fiduciary is not receiving compensation for his or her services. The fiduciary duty of loyalty may only be partially waived. To the extent that it can be waived, it should be considered in this situation.

trust instrument or contrary provisions of this subtitle, in administering the trust the trustee shall perform all of the duties imposed on trustees by the common law.

Texas Trust Code Section 113.059 provides that:

(a) Except as provided by Subsection (b) of this section, the settlor by provision in an instrument creating, modifying, amending, or revoking the trust may relieve the trustee from a duty, liability, or restriction imposed by this subtitle.

(b) A settlor may not relieve a corporate trustee from the duties, restrictions, or liabilities of Section 113.052 [Loan of Trust Funds to a Trustee] or 113.053 [Purchase or Sale of Trust Property by a Trustee] of this Act.

It should be stressed that Texas Courts pay little if any attention to the statutory provisions allowing the testator or trustor to relieve a fiduciary from fiduciary duties. The relationship between the Trust Code and Texas public policy (as interpreted by Texas Appellate Courts) is, at best, very unclear. If one were to guess where the Courts are going, it would be that no fiduciary duty may be revoked or modified if the failure to obey such duty allows self dealing, dishonesty, bad faith, recklessness or the intent to harm the distributee.

B. Types of Fiduciary Duties:

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This duty governs the standard of investment of the fiduciary estate. If the Fiduciary is allowed to invest then there must be some form of investment standard. Caution should be exercised in attempting to relieve a fiduciary from this duty in situations calling for a marital deduction trust or any type of charitable remainder trust. Subject to the above, a trustee can be relieved of this duty and be subjected to another investment standard. See *Neuhaus v. Richards*, supra.

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as a basis for determining whether the fiduciary breached his or her duty of prudence, rather than looking at the performance of the entire portfolio. Such a clause would read as follows:

"In determining whether my fiduciary has exercised prudence with respect to any investment decision, such determination shall be made taking into consideration the investment performance of all the assets of my estate or the trust estate of any trust created under my will, or all of the assets of the collective investment vehicle, as the case may be, over which my Fiduciary had management and control; in making such determination no consideration whatsoever shall be given to the prudence of any single investment."

Wills and trusts frequently contain clauses which amend existing duties of prudence. These amendments are usually contained in the provisions dealing with the powers of the Executor or Trustee. Examples of these types of clauses are clauses that allow the fiduciary to retain specified assets without liability; clauses that direct the fiduciary to invest in specific assets (such as bonds guaranteed by the full faith and credit of the United States Government); or clauses which allow the fiduciary to rely on an independent investment advisor to make investment decisions.

It may be advisable to insert a clause in the investment powers to provide for a pure portfolio test of the fiduciary's investment performance rather than the test currently contained in § 113.056 (a) of the Texas Trust Code. The issue is the extent to which a plaintiff may look at the performance of a single investment in the investment portfolio

a. It is doubtful that the personal representative of a decedent's estate may be completely relieved from this fiduciary duty unless an alternative fiduciary duty regarding the standard for investment is adopted. As indicated above, this duty is frequently amended. See Tex. Prob. Code Ann. § 230.

b. It is doubtful that a trustee may be completely relieved from this fiduciary duty unless an alternative fiduciary duty regarding the standard for investment is adopted. As indicated above, this duty is frequently amended. See Texas Trust Code § 113.056 (a).

This duty embodies the very essence of the fiduciary relationship. For this reason the public policy of the State of Texas prohibits the unrestricted waiver of this duty.

a. A personal representative probably has the common law fiduciary duties of a trustee. See Tex. Prob. Code Ann. § 37. The only fiduciary duty of loyalty specifically set forth in the Probate Code is contained in § 352 (Representative Purchasing Property of the Estate). While Texas law is not well defined regarding a testator's ability to relieve a personal representative from the duty of loyalty, the public policy restrictions outlined below with respect to trustees will probably also apply to personal representatives of decedents' estates.

b. There are numerous references in the Texas Trust Code to the fiduciary duty of loyalty. Section 113.052 (Loan of Trust Funds to Trustee); Section 113.053 (Purchase or Sale of Trust Property by Trustee); Section 113.054 (Sales From One Trust to Another); Section 113.055 (Trustee's Purchase or Retention of Stock of the Trustee or an Affiliate); and Section 113.057 (Corporate Trustee's Deposit of Trust Funds) all relate to this duty. Section 113.059 provides that a Trustor may not relieve a corporate trustee from the duties contained in §§ 113.052 and 113.053. The law is not well-defined in this area. For example, the Trust Code seems to provide explicitly that a trustor may relieve a non-corporate fiduciary of any aspect of the duty of loyalty; there are cases, however, that hold that there are public policy restrictions

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on a trustor's ability to waive this duty. There are also public policy restrictions on the extent to which a trustee may be relieved of. There also may be tax consequences of the complete waiver of the fiduciary duty of loyalty. If this duty is completely waived then the fiduciary would probably be considered the donee of a general power of appointment under § 2041 (b)(1)(A) of the Internal Revenue Code because the fiduciary could appropriate the trust estate for the benefit of himself, his creditors, his estate, or the creditors of his estate.

of Trust Property.

1 The Duty of Impartiality.

This duty is frequently waived or modified by specific provision in wills and trust instruments. Trust instruments frequently provide that distributions may be made to one class of trust beneficiaries to the complete exclusion of another class; that distributions may be made to one or more members of a class of beneficiaries to the complete exclusion of other members of the same class; or that the trustee's principal duty is to living trust beneficiaries to the complete exclusion of more remote beneficiaries. There is probably no restriction on the extent that this duty may be modified due to the fact that this duty does nothing more than define the persons entitled to share in the trust estate of the trust.

1 There is no specific statutory imposition of the duty of impartiality in the Texas Probate Code.

2 See Texas Trust Code § 113.101.

2 The Duty of Good Faith and Fair Play.

his fiduciary duty of loyalty. See the discussion of exculpatory clauses below.

This is a common law fiduciary duty; there are no provisions in the Probate Code or the Trust Code that specifically impose this duty on a fiduciary. It should be against public policy to completely relieve a fiduciary from this duty.

3 The Duty to Take Possession

It would probably be against public policy to completely relieve a fiduciary from this duty.

a. See Tex. Prob. Code. § 232 and § 233.

b. There is no provision in the Trust Code that specifically imposes this duty on a Trustee; it is, however a common law duty.

4 The Duty to Segregate Trust Assets and Not to Commingle.

This is a common law fiduciary duty; there are no provisions in the Probate Code or the Trust Code that specifically impose this duty on a fiduciary. It should be against public policy to relieve a fiduciary from this duty completely.

5 The Duty to Carry Out the Directions of the Person Creating the Fiduciary Relationship.

This is a common law fiduciary duty; there are no provisions in the Probate Code or the Trust Code that specifically impose this duty on a fiduciary. It should be against public policy to relieve a fiduciary from this duty completely.

6 The Duty to Keep Beneficiaries Informed and to Account to Them.

While limits may probably be placed on the affirmative common law duty of a fiduciary to inform beneficiaries of material nonstandard transactions affecting the administration of the estate or the trust, it is against public policy to relieve a fiduciary from the duty to account to beneficiaries. **Hollenbeck v. Hanna**, 802 S.W.2d 412 (Tex.Civ.App.--San Antonio, 1991, no writ)¹.

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The duty to inform was extended by the trial court in the currently unreported case of Calloway, [No. 91-1761-P39A) in the Probate Court Number Three of Dallas County, Texas]. In this case the court found that the trustee had fiduciary duties to: a) inform the trust beneficiaries of the pendency of a material, non-routine transaction (even if the beneficiary was a contingent beneficiary of a revocable management trust); and b) disclose to the beneficiaries of the trust material facts affecting their interests that "they need to know for their protection in dealing with a third party."

7 The Duty to Preserve and Protect the Trust Property.

This is a common law fiduciary duty; there are no provisions in the Probate Code or the Trust Code that specifically impose this duty on a fiduciary. This duty may be waived only to the extent that a fiduciary may be generally exculpated under Texas law. See *Risser*, supra.

8 The Duty Not to Delegate Trust Responsibilities.

This is a common law fiduciary duty; there are no provisions in the Probate Code or the Trust Code that specifically impose this duty on a fiduciary. Trust Code § 114.003, however, specifically allows a trustor to delegate trust powers and duties among collective co-trustees. There should not be any public policy reason to prohibit a trustor from relieving a trustee from any specific duty so long as someone is responsible for the trust administration.

9 The Duty to Keep Accurate Books and Records.

This is a common law fiduciary duty; there are no provisions in the Probate Code or the Trust Code that specifically impose this duty on a fiduciary. It should be against public policy to relieve a fiduciary from this duty completely.

10 The Duty to Make Trust Property Productive.

This is a common law fiduciary duty; there are no provisions in the Probate Code that specifically impose this duty on a fiduciary. See, however, Trust Code § 113.110. It should probably not be against public policy to relieve a

fiduciary from this duty completely.

11 The Duty to Review Trust Investments Periodically.

This is a common law fiduciary duty; there are no provisions in the Probate Code that specifically impose this duty on a fiduciary. See, however, § 113.056(c) of the Trust Code. It should probably be against public policy to relieve a fiduciary from this duty completely.

12 The Duty to Uphold and Defend the Trust.

This is a common law fiduciary duty; there are no provisions in the Probate Code or the Trust Code that specifically impose this duty on a fiduciary. See *Briggs v. Briggs*, 346 S.W.2d 106 (Tex. 1961); *Mason v. Mason*, 366 S.W.2d 552 (Tex. 1963). It should be against public policy to relieve a fiduciary from this duty completely.

13 The Duty to Investigate the Acts and Omissions of Predecessor Fiduciaries.

This is a common law fiduciary duty; there are no provisions in the Probate Code that specifically impose this duty on a fiduciary. See, however, Trust Code § 114.002. This duty is frequently waived or modified by specific provision in wills and trust instruments².

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The trial court in the currently unreported case of *Calloway*, supra, held that a fiduciary has a duty to use reasonable efforts to redress a breach of fiduciary duty by a co-trustee. In this case the trial court ignored exculpatory language in the instrument.

3 Avoid the Trustee - Beneficiary Combination.

If the only concern is with the relationship of a trustee who is also a beneficiary to another beneficiary, then a trust beneficiary should never be made a trustee. However, the tax laws often dictate the use of trusts in estate planning situations (e.g., the bypass trust to save taxes at the second death) and the logical trustee/beneficiary is usually the surviving spouse. Many times, children are used as trustee of a generation skipping trust. This is not to say that such situations are free of conflicts of interest.

Indeed, conflicts are built in, and those conflicts permeate almost every fiduciary duty of a trustee. The testator or settlor should be advised of these problems, but family and tax considerations will often cause clients to take the risk of such built-in conflicts. It is the attorney's duty to insure that the client understands the potential problems. However, the desire of the fiduciary law purist will often be overridden by more practical concerns.

The greatest concern, of course, is with the fiduciary duty of loyalty. Is the fiduciary going to make discretionary fiduciary decisions that benefit the fiduciary personally? If so, then the fiduciary may be committing constructive fraud.

The constructive fraud doctrine provides that if a fiduciary takes any discretionary action as a fiduciary which directly or indirectly benefits the fiduciary (or the fiduciary's family or affiliates) then the transaction is presumed fraudulent. The burden of proof then shifts to the

fiduciary to provide that the transaction is fair. In any transaction wherein a person benefiting from it stands in a fiduciary relationship to one or more of the other parties, the transaction, if challenged, is presumed by equity to be unfair and, therefore, a constructive fraud unless the fairness of the transaction is proven by the benefitting fiduciary.

Stephens County Museum, Inc. v. Swenson, 517 S.W.2d 257, 260 (Tex. 1974).

Unlike actual fraud, constructive fraud does not necessarily involve dishonesty of purpose or an intent to deceive and, therefore, proof of such is not required in order to invoke the doctrine.

Archer v. Griffith, 390 S.W.2d 735, 740 (Tex. 1964).

Thus, once a plaintiff establishes that the transaction which he wishes to avoid was executed while a fiduciary relationship existed between him and the defendant, the burden of presenting evidence and securing a finding that the transaction was fair to the plaintiff is put upon the defendant fiduciary who claims the validity of and benefits from the transaction.

Ginther v. Taub, 570 S.W.2d 516, 525 (Tex.Civ.App.--Waco 1975, writ ref'd n.r.e.);

Gaynier v. Ginsberg, 715 S.W.2d 749, 754 (Tex.App.--Dallas 1986, writ ref'd n.r.e.).

Evidence introduced by the defendant fiduciary to meet this burden simply creates a question of fact.

Ginther, 570 S.W.2d at 525. Absent any such proof, the presumption of unfairness and constructive fraud stands un rebutted, and the transaction is invalid as a matter of law.

Texas Bank and Trust v. A. E. Moore, 595 S.W.2d 502 (Tex. 1980). Because the burden of proof in this cause of action

is shifted to the defendant, it is distinguishable from other types of "constructive fraud" in which the entire burden rests on the party asserting it. **Miller v. Miller**, 700 S.W.2d 941 (Tex. App.--Dallas 1985, writ ref'd n.r.e.).

It is clear that under Texas law a plaintiff is not required to show that he relied upon the defendant to discharge his fiduciary duties in order to assert a claim of constructive fraud successfully. **Johnson v. Peckam**, 120 S.W.2d 786, at 788 (Tex. 1936). In **Johnson**, the Supreme Court held that the trial court had not erred in refusing to submit a special issue to the jury which called upon it to determine whether or not the plaintiff had relied upon his partner to make certain disclosures to him concerning negotiations for the sale of partnership property. It is especially dangerous to appoint a beneficiary as trustee in family situations where there is a high potential for litigation. The most obvious example of this is the situation is where the Testator (or Testatrix) and his (or her) spouse each have descendants by a prior marriage. Another dangerous situation is created when a sibling-beneficiary is appointed as the trustee of a trust where other siblings are permissive distributees.

Because of these concerns it is advisable to appoint an independent trustee. A trustee with no pecuniary interest in the trust eliminates any of the conflict of interest problems that are incident to the situations described above.

4 Draft an Explicit Purpose Clause.

Many trusts should have an explicit purpose clause. Few

As the court noted, a fiduciary is under an absolute duty to carry out the responsibilities of his position and, therefore, reliance by the plaintiff is not necessary to establish constructive fraud. See Carl David Adams, "Benefitting From Fiduciary Office: A Presumption of Fraud," 47 Tex. B.J. 648 (1984).

If a beneficiary is trustee, then there is also a problem with the duty of impartiality. It is very difficult for the fiduciary to make any decision that does not impact other beneficiaries. Any discretionary fiduciary decision that results in a distribution of principal or income to the beneficiary who is serving as trustee has the potential of being violative of the duty of impartiality.

do. The need is especially great when the trustee is given broad discretion. If the true intent of the trustor is to insure that his surviving spouse gets whatever she needs even if there is nothing left over for the remaindermen, then the trustor should say so in plain language. If the true intent of the trustor is to educate all of his children to the highest level of education reasonably attainable by each of the children without any concern for whether any of the trust remains at the time his youngest child is educated, then he should say so. If the trustee and all of the beneficiaries have a clear understanding of the purposes of the trust, they are less likely to litigate than if the purpose of the trust is left to surmise and conflicting interpretation.

5 Anticipate Environmental Problems.

1 The Clauses:

1 "Any person designated in my Will to be my executor shall be authorized, prior to qualifying as personal representative of my estate, to inspect all real and personal property which shall constitute a part of my probate estate (including interests in sole proprietorships, partnerships, or corporations and any assets owned by such business enterprises) for the purpose of determining compliance with environmental laws affecting such property and to refuse to qualify as personal representative of my estate if he determines that any property to be included in my probate estate is (a) contaminated by any hazardous substance, or (b) being used or has been used for any activities directly or indirectly involving hazardous substances, which could result in liability to my estate or otherwise impair the value of the assets held therein. Regardless of whether the person designated as my

3 Trustee's Environmental Powers. My Trustee shall have the power (a) to inspect and monitor all real and personal property held by it (including interests in sole proprietorships, partnerships, or corporations and any assets owned by such business enterprises) for the purpose of determining compliance with environmental laws affecting such property, and to respond or take any other action necessary to prevent, abate or "clean up," on behalf of the Trusts as shall be necessary, before or after the initiation of enforcement action by a governmental body, any actual or threatened violation of any environmental law affecting property held by the Trustee relating to hazardous

executor qualifies as my personal representative he shall be reimbursed from my estate for all expenses incurred in connection with such inspection."

2 "Any person serving as my executor shall have the power to (a) inspect and monitor all real and personal property held by it (including interests in sole proprietorships, partnerships, or corporations and any assets owned by such business enterprises) for the purpose of determining compliance with environmental laws affecting such property, and to respond or take any other action necessary to prevent, abate or "clean up," on behalf of my estate as shall be necessary, before or after the initiation of enforcement action by a governmental body, any actual or threatened violation of any environmental law affecting property held by my executor relating to hazardous substances in environmental laws."

substances or environmental laws; and (b) to refuse to accept property in the Trusts if my Interim Trustee determines that any property to be transferred to the Trusts is (i) contaminated by any hazardous substances, or (ii) being used or has been used for any activities, directly or indirectly involving hazardous substances, which could result in liability to the Trusts or otherwise impair the value of the assets held therein."

4 Definitions. For purposes of the foregoing provisions, "hazardous substance" shall mean any substance defined as hazardous or toxic or otherwise regulated by any federal, state or local law(s), rule(s) or

regulations(s) related to the protection of the environment or human health. Such laws are referred to herein as "environmental laws." My Fiduciary shall be entitled to charge the cost for any inspection, review abatement, response or "clean up," or any other remedial action, as authorized herein, against income or principal in his or her sole and absolute discretion."

5 "Liability of Fiduciaries."

My Fiduciary shall never be personally liable to any Distributee or any other party for any decrease in value of assets in my estate or any Trust by reason of any Fiduciary's compliance with any environmental laws, specifically including any reporting requirements under such laws."

2 Validity of the Clause:

The author has no reason to believe that these clauses are not valid. There is no Texas case specifically allowing this type of clause. The Texas Legislature amended the Texas Trust Code in the last session of the Legislature to specifically give a trustee certain environmental powers. See Texas Trust Code Ann. §113.025 - Effective September 1, 1993.

If there are multiple fiduciaries then each of the fiduciaries should actively participate in the administration of the estate or trust. If it is anticipated that both fiduciaries will not actively participate in the administration (for example, in situations where a surviving spouse and a bank trust department are co-fiduciaries and the bank makes all investment and accounting decisions), then the instrument

3 Use of the Clause: These clauses should probably be boilerplate fiduciary provisions.

6 **Define the Interrelationship Between Co-Fiduciaries.**

The appointment of multiple fiduciaries should usually be avoided. If it is unavoidable, then follow the guidelines below.

If there is more than one executor or administrator of an estate then the acts of one of them should be valid as if they had acted jointly (except for the conveyance of real estate which generally requires the joint action of all of the executors and administrators who have qualified). Tex. Prob. Code Ann. § 240. Every probate attorney dreads the situation where two or more independent executors of an estate disagree on how to administer the estate and go their separate ways, each acting alone without consulting the other.

If there are two trustees then both of them must agree on a trust decision (even though this is not expressly provided in the Trust Code). If there are three or more trustees a power may be exercised by a majority of the trustees. Trust Code § 113.085.

should be drafted in such a manner as to clearly spell out the respective powers and duties of each fiduciary³. The

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In *Calloway, supra* the court ruled that a fiduciary has the duty to monitor the competence of a co-fiduciary and to use reasonable means to redress any breach of fiduciary duty by a co-fiduciary. In making this ruling the court disregarded language in the instrument specifically limiting a fiduciary's responsibilities for the decisions of a co-fiduciary. Until an appellate decision is rendered in *Calloway*, the law is unclear regarding the extent to which language

worst scenario arises where one of the fiduciaries either does nothing or abdicates his or her role to a more forceful fiduciary and is then sued for the acts of his or her co-fiduciary. The administration of estates or trusts can also be frustrated when each co-fiduciary thinks the other co-fiduciary is responsible for a particular aspect of administration. It is a disaster to have the administration of an estate or trust deadlocked because multiple fiduciaries cannot agree. Again, avoid multiple fiduciaries whenever possible.

7 Discretionary Distribution Powers vs. Specific Distribution Criteria.

A settlor will frequently charge a trustee with the duty to make discretionary decisions with respect to the administration of the estate or trust. These decisions may include discretionary investment decisions, discretionary allocation of receipts and disbursements between the income and principal accounts, discretionary reserves for depletion and depreciation, and most frequently, discretionary income and principal distribution powers. Frequently the instrument granting discretionary decisions will provide that the exercise of discretion is "absolute," "uncontrolled" or in the "sole" discretion of the trustee. Two general schools of thought exist with respect to the type of discretionary language that should be used. One utilizes the support trust concept; the other promotes the discretionary trust concept.

limiting a fiduciary's responsibility for a co-fiduciary's acts and omissions will actually protect a fiduciary.

1 Support Trust A support trust contains a defined distribution standard and allows a beneficiary to compel the trustee to make distributions in accordance with that specific distribution standard. The distribution standard of a support trust is generally referred to as an "ascertainable standard." The standard is "ascertainable" because it is specific enough to be objectively applied. The distribution standard in a typical support trust permits distribution for the "health, support, maintenance and education" of the beneficiary.

Support trusts also often have language requiring the trustee to consider other sources of "income," "resources" and/or "assets" available to the beneficiary at the time of distribution. Some support trusts have language requiring distribution according to a certain "standard of living" that the beneficiary enjoys at a prescribed period of time.

Support distribution standards should be drafted as precisely as possible. They should specifically outline all of the criteria that the trustee is to consider; the relative importance of each member of the class of permissive distributees; any differences in criteria that should apply to principal distributions (as opposed to income distributions); and specify the manner in which the criteria are to be applied in order to make the distribution. The more specific the standards are, the closer to a mathematical formula the process becomes, and the easier it is for the fiduciary to apply the standard without incurring liability. Problems arise, of course, under this

type of standard when the fiduciary does not apply the criteria, does not obtain the information necessary to apply the criteria or does not apply the criteria in the specified manner. In short, there is always the potential that the fiduciary will incur liability for not following the standard.

2 Discretionary Trusts. A trust is considered a "discretionary trust" if the trustee is authorized to make distributions in his sole discretion. Obviously this is a subjective standard. If a settlor may provide that his trustee shall have absolute and uncontrolled discretion whether to pay or apply trust income or principal to or for the benefit of a named beneficiary, without fixing any standard or guide which the trustee is to consider, and that the income which the trustee does not elect to use for the beneficiary shall be accumulated or paid to another or to a class of other persons.

Such a trust has been called a "discretionary trust" and this term has a technical meaning for the purpose of determining the rights of the beneficiary and his assignees and creditors. It must be distinguished from trusts where the discretion of the trustee pertains only to the time or manner of the payments, or to the size of the payments needed to achieve a certain purpose, for example, to support the beneficiary. The trustee must have complete discretion to pay or apply or to totally exclude the beneficiary, if the trust is to be called "discretionary" in a technical sense.

If a discretionary trust standard is used then care should usually be taken not to impose criteria on the fiduciary. If the fiduciary has

trust is a discretionary trust, then the beneficiary may not compel the trustee to make distribution. Distributions from a discretionary trust are in the sole discretion of the trustee and are not subject to any specific distribution standard. The distribution standard of a discretionary trust is sometimes referred to as a nonobjective standard.

A description of discretionary trusts is contained in Section 228 of *Bogert, supra*.

the power to make distributions in his or her absolute discretion but must consider specific criteria then the fiduciary has the worst of all worlds. The fiduciary may be sued for failing to apply the criteria even though his or her discretion is absolute.

Unfortunately, even if a fiduciary is given absolute discretion the discretion may not, in fact, be absolute according to the courts. In general, a court will not substitute its own discretion for that of a fiduciary; at the same time, however, the court will not permit the fiduciary to abuse the discretion. Fortunately, an abuse of discretion is not usually found unless the trustee acts outside the bounds of "reasonable judgment." A court will look to the following factors in determining whether a fiduciary has abused his discretion in making a discretionary decision:

- 1 the extent of discretion conferred;
- 2 the existence of a definable external standard by which the reasonableness of the trustee can be judged;
- 3 if such a standard exists, the due diligence the trustee

used to obtain the facts necessary to comply with this standard;

4 the circumstances surrounding the decision;

5 the factors that the trustee considered in making the decision;

6 the motives of the trustee; and

7 whether or not the trustee had a conflict of interest when making the decision.

Use of the terms "absolute," "uncontrolled," "sole" and "exclusive" in granting discretion to a fiduciary does not absolve the fiduciary from acting reasonably. ***First Nat'l Bank v. Howard***, 149 Tex. 130, 229 S.W.2d 781 (Tex. 1950).

8 Anticipate the Second Marriage Litigation Syndrome.

If your client has a surviving spouse and descendants by more than one marriage, then you should anticipate discord and possible litigation if the client creates a trust for his or her surviving spouse. In this type of situation extra care should be taken to anticipate problems in the administration of the client's

This is an automatic jury question. Any time a fiduciary is directed to receive "reasonable" compensation, to make "reasonable" investments, or to provide for a "reasonable" standard of living, there is the likelihood that (un)reasonable minds will disagree on what is reasonable.

11 Remember Your Audience.

This valuable advice is taken without change from Joyce Moore's excellent paper ***The Impact of a Fiduciary Relationship In Civil Litigation***.

estate or trust; the surviving spouse should not usually be the fiduciary; there should be a very explicit purpose clause; the duties of prudence, loyalty and impartiality should be carefully defined; and the distribution standard should be carefully drafted to anticipate problems.

9 Specifically Provide for the Allocation of Receipts and Disbursements.

Particular attention should be given to the fiduciary's power to allocate receipts and disbursements between the principal and income accounts.

Misallocation of receipts and disbursements is a common allegation in fiduciary liability litigation. Consideration should be given to whether receipts and disbursements should be allocated in strict compliance with the provisions of Subchapter D of the Texas Trust Code, in the sole discretion of the executor or trustee, or according to an independent standard established by the testator or the trustor.

10 Avoid the Word "Reasonable."

Any will or trust you draft will be read by your client, his family, the executor, the trustee, any distributees or beneficiaries and their attorneys. In today's legal climate it is not unlikely that it will also be read by a judge and a jury. In any event, always remember that the majority of your audience will not be lawyers. When you draft a will or a trust concentrate on using "plain English." The document should not be so complicated that only another estate planner can

understand it. While I realize this is easier said than done, it may help if you try to visualize the typical jury that could end up being the final critic of your work. If you can express your ideas in a way that this group of lay persons can readily understand what you intended to say then you are truly an "advanced estate planner." Even though the makeup of jury panels will vary considerably from one part of the state and country to the next, there are certain traits in common in the majority of panels that may be helpful to consider:

(a) Expect no more than a high school education; hope they all speak English fluently;

(b) On average, anticipate that they will earn approximately \$15,000 to \$25,000 per year;

(c) Realize that most jurors will not need or have sophisticated estate plans or trusts of their own, and may not like anyone who does;

(d) They do not trust lawyers and resent legal intrusions into the management of their personal affairs;

(e) At least one-half of the women on the panel will resent any inference or suggestion that the wife or daughter is not mentally competent (in a business sense or otherwise) to handle money, the other half

(n) Most of the time they will do what is right in spite of the most sophisticated attempts to draft language exculpating the fiduciary.

of the women would love to "be taken care of;"

(f) Over half of the men would love to tie up the money so their wife (or daughter) couldn't "waste" it;

(g) All of the men will be horrified at any suggestion that a grown man shouldn't have complete control of his funds;

(h) Either they or someone they know has experienced a family dispute over an inheritance or a gift;

(i) They expect any fiduciary who has been paid "real money" for his services to be close to perfect;

(j) They have all felt cheated at some time or another by someone they trusted;

(k) They have better things to do than to sit in some courtroom day after day listening to people fight over large sums of money while they won't even get enough from their jury service to cover their parking and lunch costs;

(l) Small children are protected, adult children who are living on parental money are viewed with distaste and suspicion;

(m) If they can't understand what you wrote they will make up what they think is fair;

The best way to "jury" test your product is to have your secretary or your receptionist read the document and then tell you

what they understood or didn't understand. Be careful when you "cut and paste," the accidentally dropped line or word can create significant problems.

Also, be sure to re-read your "boilerplate" language every time you use it. What may have made good sense two years ago may not seem so clear today.

II.

FIDUCIARY PROTECTION CLAUSES

A0 Exculpatory Clauses.

1 The Clause: "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 Validity of the Clause: Exculpatory clauses are valid in Texas. **Corpus Christi National Bank v. Gerdes**, 551 S.W.2d 521 (Tex.Civ.App.--Corpus Christi 1977, writ ref'd n.r.e.); **Neuhaus v. Richards**, supra; **Interfirst Bank of Dallas, N.A. v. Risser**, 739 S.W.2d 882 (Tex.Civ.App.--Texarkana 1987, no writ). Exculpatory clauses will, however, be strictly construed against exculpation. **Jewett v. Capital National Bank of Austin**, 618 S.W.2d 109 (Tex.Civ.App.--Waco 1981, writ ref'd n.r.e.). However, there are public policy limitations on the use of exculpatory clauses. The court in **Risser**, supra, at 888 stated the limitations as follows:

Provisions in an instrument creating the trust can relieve the trustee of certain duties, restrictions, responsibilities, and liabilities imposed on him by statute... However, the language of a trust instrument cannot authorize self-dealing by a trustee, because that would be contrary to public policy...

This limitation should include any situation in which a trustee used the position of trust to obtain an advantage by action inconsistent with the trustee's duties and detrimental to the trust. Neither can an exculpatory provision in the trust

3 Use of the Clause: Provisions eliminating the liability of a fiduciary should not be routinely used. The threshold question to consider in evaluating the use of this type of clause is whether the settlor of the instrument would want the objects of his or her bounty to suffer material economic loss in order to protect the fiduciary from liability. Even if the answer to this question is "yes," there remains a question regarding the degree of protection that the settlor would want the fiduciary to have.

Consideration of the use of any exculpatory clause should begin with the question: "If the fiduciary breaches his trust and as a consequence thereof causes damage to the trust estate, then who would the settlor want to bear the loss?" Would the answer to this question be different if the fiduciary committed intentional malfeasance rather than negligence?

As a general proposition, if a fiduciary has a close personal relationship with the settlor of the instrument, and if the fiduciary is not receiving compensation for his services

1 The Clause: "As a condition to the taking, vesting, receiving or enjoying of any property, benefit or thing whatsoever under or by virtue of this Will or any trust created under this Will, any Distributee shall accept

instrument be effective to relieve the trustee of liability for action taken in bad faith or for acting intentionally adverse or with reckless indifference to the interests of the beneficiary...

as a fiduciary, then some form of exculpation from fiduciary liability may be warranted. For example, if a settlor appoints his wife as trustee of a trust for his children, to serve without compensation, then the settlor may want to limit the trustee's potential liability.

On the other hand, a law firm that includes an exculpatory clause as boilerplate in its estate planning documents is courting disaster. This is especially true when the fiduciary is an entity with whom the law firm has a pre-existing relationship (such as a bank that the law firm represents on a regular basis).

Also, if the fiduciary is a corporation charging a full fee for its services as a fiduciary, then exculpation of the fiduciary from liability is hard to justify. In fact, the traditional reason for appointing a corporate fiduciary was the financial resources of a corporate fiduciary to make good any loss they caused the estate or trust (before they went broke in the 1980's).

B0 In Terrorem Clauses.

and agree to all of the provisions of this Will and that the provisions of this In Terrorem Clause are made an essential part of each and every benefit in and under this Will. If any Distributee hereunder, directly or

indirectly, individually or with another, shall contest the probate or validity of this Will, or any provision thereof; or shall institute or join in (except as a party defendant) any proceeding to contest the validity of this Will or to prevent any provision hereof from being carried out in accordance with its terms or shall acquiesce therein; or shall fail or refuse to defend this Will or any provision herein; or shall in any manner question or dispute any statement or declaration herein; or shall in any manner aid, assist or encourage another in any such contest or questioning; or shall contest, question or oppose in any legal proceeding the performance by my Fiduciary (as defined elsewhere herein) of any duty, act or discretion granted to or incumbent upon him or her under the terms of this Will or by law; or shall in any manner institute or participate in (except in support of my Fiduciary) any construction of any provision of this Will by means of any declaratory judgment proceeding (without the prior written approval of the designated personal representative of my estate or, if applicable, my trustee); or shall in any manner institute or participate in any proceeding (except in support of my Fiduciary) to contest or in any manner question any accounting prepared by or on behalf of my Fiduciary; or shall institute any cause of action (including, but not limited to, any cause of action for tortious interference with inheritance rights) against any person which is based in any way on the proposition that I was not of sound mind, lacked testamentary capacity, was unduly influenced, or failed to comply with any applicable law at the time that I executed any

legal instrument (any of the acts described above are hereinafter referred to as "Prohibited Acts"); then, in any such contingency, all benefits provided for such Distributee are revoked and such benefits shall pass to the Residuary Distributees under this Will (other than such Distributee, such Distributee's spouse and any of such Distributee's lineal descendants), or if applicable the Residuary Distributees of any trust in the proportion that the share of each such Residuary Distributee bears to the aggregate of the effective shares of the residuary. If all of the Residuary Distributees join in any Prohibited Acts, then such benefits shall pass to those persons (other than the persons joining in such Prohibited Acts, their spouses and their descendants) who are living at the time of my death or, if applicable, the date of the termination of any trust created under this will, and who would have been my Distributees had I died intestate a resident of the State of Texas at such time and had the person or persons contesting my Will or engaging in the Prohibited Acts died immediately before me, unmarried and without issue. If all Distributees herein and all heirs at law so act to incur the penalty of forfeiture, I give such benefits and properties to _____, a charitable institution. If any distribution has been made to any Distributee prior to the time he engages in a Prohibited Acts, then the Distributee shall repay to my Fiduciary or, if applicable, to my trustee, the amount of any such distribution plus simple interest at a rate of six per cent per annum and all attorney

fees and expenses incurred in collecting this distribution and any adult Distributee must agree in writing to this provision of this Will prior to receiving or continuing to receive any distribution. To the greatest extent permitted by Texas law this provision of this Will shall apply to any Distributee regardless of whether or not any Prohibited Acts was taken in good faith and with probable cause. If my Fiduciary elects to take a marital deduction or charitable deduction on my Federal Estate Tax return then no provision of this In Terrorem clause shall apply to my surviving spouse or, if applicable, to any charity. This provision shall survive the administration of my estate and shall expressly apply to the administration of any trust created in this Will.

No distributee shall be deemed to have violated this clause solely because he or she disclaims any interest in my estate and any trust created under this Will."

2. Validity of the Clause:

In terrorem clauses are valid in Texas. See *Hammer v. Powers*, 819 S.W.2d 669 (Tex.Civ.App.-- Ft. Worth 1991, no writ); *Calvary v. Calvary*, 122 Tex. 204, 55 S.W.2d 527 (Tex. Comm. App.1932, opinion adopted); *Massie v. Massie*, 118 S.W. 219 (Tex.Civ.App. 1909).

In terrorem clauses will, however, be strictly construed. **Remember the carrot and the stick!** In order for an in terrorem clause to be effective, a substantial gift must be made to the potential litigant. It is the risk of losing the gift, in theory, which prevents the contestant from filing a lawsuit. I have seen wills containing in terrorem provisions that leave a potential litigant only one

See *Estate of Newbill*, 781 S.W.2d 727 (Tex.Civ.App.-- Amarillo 1989, no writ); *Gunter v. Poague*, 672 S.W.2d 840 (Tex. Civ. App.-Corpus Christi 1984, writ ref'd n.r.e.); *Sheffield v. Scott*, 662 S.W.2d 674 [Tex.Civ.App.--Houston (14th Dist.) 1983, writ ref'd n.r.e.)

There are public policy restrictions on the applicability of in terrorem clauses. Even if a will or trust contains an in terrorem clause, if the contest or other litigation is brought "in good faith and with probable cause for recovery" Texas courts will probably not enforce the In Terrorem Clause. See *Hammer*, supra, and *Calvary*, supra.

3. Use of the Clause: Like exculpatory clauses, in terrorem clauses should never be boilerplate provisions in a will or trust. The same considerations apply to in terrorem clauses as were discussed with respect to exculpatory clauses above. An in terrorem clause is an extraordinary weapon that should only be used when there is real concern about a meritless contest of the instrument or a lawsuit against the fiduciary. Most creators of instruments would not want to sacrifice the objects of their bounty to protect their fiduciaries.

dollar. In such wills the in terrorem clause is totally ineffective because there is no incentive for the litigant to refrain from filing a lawsuit.

The amount of the gift to the potential litigant should be substantial enough to prevent the litigation but less than the cost of defending the litigation.

CAVEAT: While in terrorem clauses are generally valid in Texas, I have included some provisions in the above clause expressly for this paper. They have not been ruled on by any court and may or may not be in conformity with the public policy of this state as determined in the future by Texas Courts.

C0 Legal Expense Clauses.

1 The Clause: "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."

2 Validity of the Clause: Generally a trustee is entitled to reimbursement from the trust estate for expenses which the trustee, acting in good faith, incurs in defense of litigation charging him with breach of trust. *Du Pont v. Southern National Bank*, 771 F.2d 874 (5th Cir. 1985); *Grey v. First National Bank*, 393 F.2d 371 (5th Cir. 1968). There is no authority for the proposition that this clause is or is not enforceable in this state.

3 Use of the Clause: This clause should not be boilerplate. Again, the purpose of this clause is to protect the fiduciary at the expense of the objects of the bounty of the person drafting the clause.

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Fiduciary litigation is usually extremely time consuming, expensive and emotionally draining for the family. Most cases require the use of expert witnesses (such as accountants, appraisers, investment specialists, economists etc.) as well as numerous hours of attorney time for preparing the case and presenting it at trial. The recent advent of viable alternatives to litigation may provide a means of reducing the costs normally associated with trial. For this reason arbitration or mediation clauses should be considered. Such clauses could provide that any party to the instrument who accepts compensation for serving as a fiduciary or the benefits conferred on a beneficiary automatically agrees that any other party can force mediation or arbitration of disputes. While it is not clear whether "binding" arbitration in these cases would be upheld, my experience indicates that even nonbinding mediation can be extremely helpful in settling disputes or, at the least, narrowing the issues for trial.

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Services, Inc. 1417 Montana Avenue, El Paso, Texas 79902.

If a clause is used that requires arbitration in every dispute situation, then consideration should be given to the fact that if the dispute involves tax considerations, then it may be desirable to obtain the opinion from a Court to bind the taxing authorities.

If an arbitration clause is warranted, then a helpful source for language is the American Arbitration Association Dispute Resolution Pamphlet. The American Arbitration Association is located at 140 West 51st Street, New York, NY 10020-1203 (212) 484-4000. Information may also be obtained from the Texas Arbitration Mediation

If arbitration is used then some process should be implemented for discovery. Discovery is frequently not available in alternate dispute resolution matters. Fiduciary litigation frequently requires both discovery and the use of experts.

If arbitration is used then who should arbitrate? One suggestion is a panel of three board certified experts in Estate Planning and Probate Law.

1 The Arbitration Clause⁴:

a. All controversies, claims, demands or disputes that may arise in connection with the probate or construction of my Will, the administration of my estate, the distribution of my estate, the administration or construction of any trust created in my Will, or with the distribution of the trust estate of any trust created in my will shall be settled by arbitration as set forth herein. The purpose of this provision in my Will is to make the submission to arbitration of any dispute described herein an express condition precedent to receipt of benefits under my Will, from my estate, or from any trust created in my Will..

b. The initiating party to a dispute shall (a) give written notice to all other interested

persons of its intention to arbitrate, which notice shall contain a statement setting forth the nature of the dispute, the amount involved (if any), the remedy sought, and the hearing locale requested, and (b) shall file at the regional office of the American Arbitration Association (the "AAA"), nearest the Court having jurisdiction over my estate (or, if applicable, any trust created in this Will), three copies of the notice and three copies of this provision of my Will, together with the appropriate filing fee.

c. To the extent that they exist and are applicable to the controversy, claim, demand or dispute in question, the rules of the AAA with respect to the arbitration of will disputes (or, if applicable, trust disputes) shall be deemed to have been made a part of my Will. These rules and any amendment of them shall apply in the form obtaining at the time the demand for arbitration is received by the AAA; provided, however, that if the applicable rules do not provide for reasonable discovery to the parties to the proceeding then the persons arbitrating the proceeding shall provide reasonable opportunity for the parties to obtain discovery.

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The genesis of this clause is a clause contained in a paper given at the American College of Trust and Estate Counsel, Annual Meeting, March 1994 by Nikki T. DeShazo and Edward V. Smith, III entitled *Alternative Dispute Resolution in Probate Cases*. To the extent that this clause is valid, and accomplishes the purposes set out therein, then Nikki T. DeShazo and Edward V. Smith should be given full credit. To the extent that the clause is not valid, or does not accomplish the purposes set out therein, the author should probably be blamed for modifying the clause.

d. All controversies, claims, demands or disputes which are subject to arbitration hereunder represent the exclusive remedy for resolving disputes which arise in connection with the probate of my Will, the construction of my Will, the administration of my estate, the distribution of my estate, the administration of any trust created in my Will or the distribution of any trust created in my Will. No suit at law or in equity shall be instituted by any interested person except to enforce the award of the arbitrators.

e. If any distributee fails to abide by this provision and in any way directly or indirectly attempts to initiate a controversy, claim, demand, or dispute which is subject to arbitration hereunder, other than in accordance with this provision of my Will, then such contesting distributee (and any other distributee who materially cooperates with him or her in such endeavor) forfeits any share of my estate (and any share of any trust created in my Will) and such share shall be disposed of as if that contesting beneficiary or remainderman had predeceased me unmarried and without issue.

2 The Mediation Clause⁵:

a. All controversies, claims, demands or disputes that may

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The genesis of this clause is also a clause contained in a paper given at the American College of Trust and Estate Counsel, Annual Meeting, March 1994 by Nikki T. DeShazo and Edward V. Smith, III entitled *Alternative Dispute Resolution in Probate Cases*. To the extent that this clause is valid, and accomplishes the purposes set out therein, then Nikki T. DeShazo and Edward V. Smith should be given full credit. To the extent that the clause is not valid, or does not accomplish the purposes set out therein, the author should probably be blamed for modifying the clause.

arise in connection with the probate or construction of my Will, the administration of my estate, the distribution of my estate, the administration or construction of any trust created in my Will, or with the distribution of the trust estate of any trust created in my Will shall first be submitted to mediation as a condition precedent to proceeding with any suit at law or equity concerning any such controversy, claim, demand or dispute.

b. It is my suggestion that the mediator chosen to help resolve any dispute arising hereunder will be an attorney who has had experience in alternative dispute resolution and an expert in estate planning and probate law. I further suggest that such attorney be Board Certified by the State Bar of this State in Probate and Estate Planning Law.

c. It is my express intention in adding this clause to my Will to provide a method of preserving my estate (and the trust estate of any trust created in my Will) for the distributees and my hope that, should a dispute arise, my estate (or the trust estate of any trust created in my Will) not be dissipated through costly litigation. It is my further belief that by utilizing the mediation process the persons involved in any dispute are more likely to remain compatible than if they oppose each other in court.

3. Validity of the Clause: There is no definitive authority for the proposition that these clauses are or are not enforceable in this state. Texas courts look favorably, however, on almost all attempts to arbitrate or mediate a dispute.

4. Use of the Clause: These clauses should not be boilerplate. An Arbitration or Mediation clause should be used with extreme caution. Texas law is very unclear regarding the enforceability of either type of clause. The mediation clause (set forth in paragraph 2. above) should never be used in the same instrument as the arbitration clause (set forth in paragraph 1. above).

III.

CONCEPT CLAUSES
(WE AREN'T IN KANSAS ANYMORE)

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The clauses that follow have been drafted in response to ~~issues~~ **Actions** frequently arise in fiduciary litigation. They constitute a "wish list" of clauses the author would like to see in an instrument when he is defending the fiduciary, and clauses that he would dread to see in an instrument when he is suing the fiduciary. To the best of my knowledge there is no Texas case or statute that either blesses or condemns any of these clauses. They should, therefore, be used at your own risk and only in specific situations where the facts of the particular case warrant their use. I recommend that they not be included in your boilerplate fiduciary powers.

B0 Imposed Limitation of

1 The Clause:
"Notwithstanding any Texas statute to the contrary, no person who is interested in my estate or any trust created under my Will shall institute any cause of action which is appertaining to or incident to my estate or any trust created under this Will after one year from the earlier of (a) the date on which such person first learned of the factual basis for such cause of action or (b) the date on which such person first learns facts which would compel a reasonable person to investigate further the factual

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basis for any such cause of action."

2 Use of the Clause. If this clause is not used in connection with an in terrorem clause then provisions should be added to provide that each distributee should specifically agree to this provision in writing as a condition precedent to receiving or continuing to receive any benefit and that such beneficiary forfeits his or her interest in the estate or trust if he or she institutes any cause of action after such time.

C0 Virtual Representation.

1 The Clause: "Only living persons shall be necessary parties in any cause of action incident to or appertaining to my estate or any trust created under this Will. It is also my desire that no attorney ad litem be appointed to represent any unknown heirs, unnamed contingent beneficiaries designated as a class or unascertained distributees under this Will (or any trust created under this Will), and to this end I declare that I would prefer for such distributees to take nothing from my estate (or any trust created under this Will) rather than for my estate or trust to bear the cost of ad litem fees in any legal proceeding affecting them. I further direct that any judgment, order, or decree entered in any court of competent jurisdiction in any cause of action appertaining to or incident to my estate (or any trust created under my Will) shall be as fully binding against any unknown heirs, contingent beneficiaries designated as a class or unascertained beneficiaries as if such persons were living and a party

to the proceeding at the time the judgment, order, or decree was entered."

2 Use of the Clause: This is a clause which, if valid should probably be used in most wills and trusts. The fees of attorneys ad litem in fiduciary litigation is staggering. The appointment of ad litem often inhibits settlement of fiduciary litigation cases due to the fact that the ad litem, as fiduciaries, do not have the same flexibility to settle disputes that is available to direct parties. Finally, when an ad litem is appointed then there is one more lawyer examining the acts of the fiduciary. This alone increases the likelihood of fiduciary litigation.

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1 The Clause: "My Fiduciary shall have the power and authority to bind each and every Distributee of my estate (or any trust created under my Will) to the settlement of any legal proceeding involving my estate or any trust created under my Will. The signature of my Fiduciary on any settlement agreement shall absolutely and completely bind each and every Distributee (known or unknown, vested or contingent, ascertained or unascertained, living or unborn, minor or adult) who is not an actual party to the legal proceeding as fully as if such person were a legally competent and fully vested distributee who actually entered into the agreement with full knowledge of all relevant facts necessary to legally bind himself or herself to settlement agreement. If my Fiduciary enters into any form of settlement agreement contemplated by this paragraph then he or she shall have no liability whatsoever to anyone for any liability that directly or indirectly arises out of or by virtue of such settlement unless my Fiduciary entered into such agreement for the primary purpose of securing personal gain from the settlement.

E0 Imposition of Legal Fees on Unsuccessful Litigants.

1 The Clause: If a Distributee shall institute or actively participate (except in support of my Fiduciary) in any cause of action against any person serving as personal representative of my estate (either individually or in a representative capacity) or trustee of any trust under my Will (either individually or in a representative capacity) which seeks to attack in any way the validity of all or any part of this Will; to construe all or any part of this Will (without the prior written consent of my personal representative or, if applicable, my trustee): to contest any act or omission of any person serving as personal representative of my estate; to contest any act or omission of any person serving as trustee of any trust created under this Will; to remove any person serving as personal representative of my estate; to remove any person serving as trustee or any trust created under this Will; to contest in any manner any inventory or other accounting filed by the personal representative of my estate; or to contest in any manner any accounting filed by the trustee of any trust

created under this Will; and if such person shall not prevail, then and in that event, such Distributee shall receive no further distribution from my estate, or, if applicable, from any trust created under this Will until such person reimburses either my estate or, if applicable, my trust, an amount equal to the total amount of legal fees and expenses of litigation incurred by either my personal representative or my trustee (in his individual and/or his representative capacity) in defending the cause of action referred to herein."

2 Use of the Clause: This clause should not be boilerplate because it sacrifices the inheritance rights of the objects of the settlor's bounty to protect the fiduciary.

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1 The Clause: "No Distributee may bring any cause of Action against my Fiduciary derivatively on behalf of my estate or any trust created under this Will. The prohibitions contained in this paragraph shall be in full force and effect and shall apply regardless of whether my Fiduciary refuses to bring the cause of action on behalf of my estate or any such trust; whether my Fiduciary has a conflict which prevents my Fiduciary from bringing the

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cause of action, or whether the cause of action is against my Fiduciary. Subject to any other provision in this instrument prohibiting litigation by any Distributee, nothing in this paragraph shall prevent any Distributee from bringing any cause of action (which is not prohibited by this instrument) in his individual capacity as a Distributee and to seek any damages that he or she may have actually suffered. The Distributee may not, however, bring any derivative cause of action to collect damages on behalf of my estate or any trust created under this Will."

2 Use of the Clause: Many causes of action are brought. The ability to bring a derivative cause of action is an incentive to the plaintiff's attorney in that it potentially increases the recovery (if he or she has a contingent fee contract) and creates the possibility of obtaining payment of legal fees and litigation expenses from the estate or trust (rather from the plaintiff's own pocket) from the very outset of the litigation. The elimination of this right, if it may be lawfully inhibited, would certainly inhibit litigation against the fiduciary.

GO Creation of Privilege Between My Estate or Trust and My Fiduciary

1 The Clause: "The normal attorney client privilege and protection of attorney work product (collectively, the "Fiduciary Privilege") shall apply to any Fiduciary Attorney as defined herein. The Fiduciary Privilege shall apply to the relationship between my Fiduciary and the Fiduciary Attorney with respect to any Distributee. No Distributee shall be permitted to compel, in any proceeding, the

against the fiduciary as derivative causes of action. Texas law generally provides that a cause of action on behalf of an estate may only be brought by the personal representative of the estate or that a cause of action on behalf of a trust may only be brought by the trustee. An exception to this general rule exists when the fiduciary refuses to bring the cause of action, when the fiduciary has a conflict of interest, or where the cause of action is against the fiduciary. In these situations a distributee may bring a cause of action on behalf of the estate or trust.

production of any information covered by the Fiduciary Privilege. This prohibition shall apply even if my Fiduciary is a defendant in the proceeding. Notwithstanding anything to the contrary in this paragraph, if in any proceeding my Fiduciary shall claim as a defense that he or she relied on the advice of the Fiduciary Attorney or if my Fiduciary (or attorney associated with my Fiduciary in the practice of law) is the Fiduciary Attorney, then, and in that event, any Distributee may compel discovery of information to the extent that such information would have been available to such Distributee but for this paragraph."

2 Use of the Clause: There is generally no privilege between the attorney representing the Fiduciary and the distributees of the estate or trust. The attorney representing the fiduciary in the general administration of the estate or trust is performing legal services for the distributees as well as the fiduciary, so no privilege

attaches. Once litigation arises between a distributee and the fiduciary, if the fiduciary continues to use the same attorney to represent him or her, then privilege attaches to all future legal services related to the litigation. The distinction between when the attorney is representing the fiduciary in the administration of the estate or trust and when the attorney is defending the fiduciary is sometimes very vague. This clause provides that privilege attaches to all legal representation rendered to the fiduciary and expressly negates a distributee's ability to access any legal files in fiduciary litigation against the fiduciary.

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1 The Clause: "If any cause of action is brought against my Fiduciary, in either his or her individual or representative capacity, then I specifically authorize my Fiduciary to retain my Fiduciary Attorney to represent him or her in connection with the Fiduciary Litigation (as defined herein). I recognize that there may be conflicts of interest between an attorney or law firm representing both my Fiduciary in the administration of my estate or any trust created under my Will and my Fiduciary in connection with the Fiduciary Litigation, and I expressly waive the conflicts. Not Distributee shall be permitted to disqualify or remove any Fiduciary Attorney in any legal proceeding because of the fact that he or she represents my Fiduciary in connection with the administration of my estate or any trust created under my Will and also represents my Fiduciary."

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2 Use of the Clause: If the fiduciary uses the same attorney or law firm to represent him or her in connection with the administration of the estate or trust and to defend him or her in fiduciary litigation, the question usually arises regarding whether or not the attorney or law firm has a conflict of interest and should be disqualified from continuing to represent the fiduciary in either capacity. This clause attempts to eliminate this potential conflict. The attorney's activities will still be governed by the canons of ethics and disciplinary rules. The purpose of this clause is to prevent disqualification by the court

in the fiduciary litigation proceeding.

IO Privity of Contract - Distributees Against the Attorney or Law Fiduciary.

prohibit these types of actions.

1 The Clause: "I expressly prohibit any distributee from instituting, maintaining or materially participating in any legal proceeding (that is incident to are appertaining to the probate of my Will, the administration or distribution of my estate, or the administration or distribution of any trust created in my Will) against either the attorney or the law firm representing my Fiduciary (in connection with the probate of my Will, the administration or distribution of my estate or the administration or distribution of any trust created in my Will). This prohibition specifically applies to (but is not limited to) any proceeding for professional malpractice, professional misconduct, conspiracy to breach fiduciary duty, fraud, constructive fraud, interference with inheritance rights, or interference with the administration of my estate or any trust created in my Will. This prohibition shall be enforced to the greatest extent permitted by Texas law."

2 Use of the Clause: Texas courts have, to date, ruled that the attorney (or law firm) representing a fiduciary does not have privity of contract with the beneficiaries of the fiduciary relationship. As a consequence, many plaintiff's attorneys are instituting suits against attorneys for fraud, conspiracy to commit a breach of fiduciary duty, and other causes of actions to attempt to circumvent the privity rule. This clause, if valid, would