

SPECIALTY DRAFTING REGARDING THE FIDUCIARY

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PRELIMINARIES

6.1 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."

6.1.1 **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.

0.0.1 **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.

6.1.2 **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.

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

- 6.2.1 **Fiduciary** refers 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.
- 6.2.2 **Distributee** refers to any distributee under a will as well as any beneficiary of any trust.
- 6.2.3 **Fiduciary Attorney** refers to the attorney or law firm representing a fiduciary in connection with the administration of an estate or any trust.
- 6.2.4 **Fiduciary Litigation** refers to any legal proceeding appertaining to the administration of an estate or the administration of any trust in which a fiduciary is a party, in either his individual or representative capacity, or to 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).

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GENERAL DRAFTING CONSIDERATIONS

- 7.1 **Consider Customizing Fiduciary Powers and Duties:** Fiduciary powers and duties may be created by statute, by the common law, or by the instrument creating the fiduciary relationship. Most fiduciary powers and duties may be either modified or revoked by the person creating the fiduciary relationship. In limited situations a trustee or a distributee may apply to a court to modify or eliminate fiduciary powers and/or duties. Any draftsman should carefully select and define the powers and duties granted 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 often not adequate to provide for the specific needs of a client. More importantly, most trustees and distributees are not familiar with either the statutory or common law fiduciary powers and duties. If the powers and duties are specifically spelled out in the instrument, then both the trustee and the distributees will be able to at least read the instrument and have a basic understanding of what the trustee is authorized to do.

Most fiduciary liability litigation involves alleged breaches of the fiduciary duties of prudence, loyalty or impartiality. Special attention should be given to these duties.

7.1.1 **Distinction Between Fiduciary Powers and Duties:** There are significant differences between fiduciary powers and fiduciary duties. These differences often get confused in the drafting and/or interpretation of wills and trusts. The distinction between a power and a duty can be difficult to comprehend. As observed below, the language Amy fiduciary shall have the power to sell Black Acre@ clearly involves the grant of a power. The language Amy fiduciary shall have the power to sell Black Acre to himself@ involves both the grant of a fiduciary power and the modification of a fiduciary duty (the duty of loyalty).

7.1.1.1 **Fiduciary Powers:** A fiduciary power@ is the grant of authority to a fiduciary to act while administering the fiduciary estate.

For example, a will or trust may provide that Amy fiduciary shall have the power to sell Black Acre@. This language constitutes the grant of a power. The fact that the fiduciary has the power@ to sell Black Acre does not necessarily mean that the fiduciary has the power to sell Black Acre to himself (a potential breach of his duty of loyalty) or to sell Black Acre to a third party at an unfair price (a potential breach of his duty of prudence).

Most fiduciary powers may be defined, enlarged or withdrawn almost without limitation.

7.1.1.2 **Fiduciary Duties:** A fiduciary duty@ is the imposition on a fiduciary of an obligation, prohibition or responsibility while exercising a fiduciary power.

Fiduciary duties are not usually set forth in detail in a will or trust. Consequently, the fiduciary's duties are often established by the default provisions of the Probate Code, the Trust Code or by common law.

7.1.1.3 **Types of Fiduciary Duties:**

7.1.1.3.1 **The Duty of Prudence:** [*American Law Institute, Restatement of the Law, Third, Trusts '227*] 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.

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 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."

7.1.1.3.1.1 **Relieving an Executor of The Duty of Prudence:** 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.

7.1.1.3.1.2 **Relieving a Trustee of the Duty of Prudence:**

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).

7.1.1.3.2 **The Duty of Loyalty:** [*American Law Institute, Restatement of the Law, Second, Trusts '170*] 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.

7.1.1.3.2.1 **Probate Code:** 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.

7.1.1.3.2.2 **Trust Code:** 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 Sections 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 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 his fiduciary duty of loyalty. See the discussion of exculpatory clauses above.

7.1.1.3.2.3 **Common Law:** There are numerous cases outlining the common law of Texas relating to the fiduciary duty of loyalty. See: *Johnson v. Peckham*, 120 S.W.2d 786 (Tex. 1938); *Slay v. Burnett Trust*, 187 S.W.2d 153 (Tex 1945); *Archer v. Griffith*, 390 S.W.2d 735 (Tex. 1964); *Kinzbach Tool Company v. The Corbett-Wallace Corporation*, 160 S.W.2d 509 (Tex. 1942); *Langford v. Shamburger*, 417 S.W.2d 438 (Tex. App.B Ft Worth -1967); *Stephens County Museum v. Swenson*, 517 S.W.2d 257 (Tex. 1974); *Texas Bank & Trust Company v. Moore*, 595 S.W.2d 502 (Tex. 1980); *Interstate Bank Dallas v. Risser*, 739 S.W.2d 882 (Tex. Civ. App. B Texarkana 1987).

7.1.1.3.2.4 **Tax Consequences:** 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.

7.1.1.3.3 **The Duty of Impartiality:** [*American Law Institute, Restatement of the Law, Second, Trusts '183*] 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 distributees to the complete exclusion of another class; that distributions may be made to one or more members of a class of distributees to the complete exclusion of other members of the same class; or that the trustee's principal duty is to living trust distributees to the complete exclusion of more remote remainder distributees. 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.

7.1.1.3.3.1 **Probate Code:** There is no specific statutory imposition of the duty of impartiality in the Texas Probate Code.

7.1.1.3.3.2 **Trust Code:** See Texas Trust Code Section 113.101.

7.1.1.3.4 **The Duty of Good Faith and Fair Play:** 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.

7.1.1.3.5 **The Duty to Take Possession of Trust Property:** [*American Law Institute, Restatement of the Law, Second, Trusts '175*] It would probably be against public policy to completely relieve a fiduciary from this duty.

7.1.1.3.5.1 **Probate Code:** See Tex. Prob. Code. ' 232 and ' 233.

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

7.1.1.3.6 **The Duty to Segregate Trust Assets and Not to Commingle:**[*American Law Institute, Restatement of the Law, Second, Trusts '179*] 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.

7.1.1.3.7 **The Duty to Carry Out the Directions of the Person Creating the Fiduciary Relationship:** [*American Law Institute, Restatement of the Law, Second, Trusts '169*] There are no provisions in the Probate Code that specifically impose this duty on a fiduciary. See Tex. Trust Code '113.051. It should be against public policy to relieve a fiduciary from this duty completely.

7.1.1.3.8 **The Duty to Keep Distributees Informed and to**

Account to Them: [*American Law Institute, Restatement of the Law, Second, Trusts '172-172*] While limits may probably be placed on the affirmative common law duty of a fiduciary to inform distributees 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 distributees. *Hollenbeck v. Hanna*, 802 S.W.2d 412 (Tex.Civ.App.--San Antonio, 1991, no writ). Numerous Texas cases have dealt with a fiduciary's duty of disclosure. See *Shannon v. Frost National Bank*, 533 S.W.2d 389 (Tex. App. B San Antonio, 1975, writ ref=d n.r.e.); *Montgomery v. Kennedy*, 669 S.W.2d 309 (Tex. 1984); *Huie v. DeShazo*, 922 S.W.2d 920 (Tex. 1996)

7.1.1.3.9 **The Duty to Preserve and Protect the Trust Property:**

[*American Law Institute, Restatement of the Law, Second, Trusts '176*] 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 it does not violate the public policy limitations set forth in *Risser*, supra.

7.1.1.3.10 **The Duty Not to Delegate Trust Responsibilities:**

[*American Law Institute, Restatement of the Law, Second, Trusts '171*] 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.

A recent amendment to the Trust Code authorizes a settlor to provide for an investment agent and, in certain circumstances to avoid responsibility for the investment decisions made by such agent. See Tex. Trust Code '113.060

There should not be any public policy reason to prohibit a trustor from delegating any specific duty so long as someone is responsible for the trust administration. Unless the trustee is protected by statute (or possibly

provisions in the will or trust), the trustee may be liable for consequences of delegation.

7.1.1.3.11 **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.

7.1.1.3.12 **The Duty to Make Trust Property Productive:** [*American Law Institute, Restatement of the Law, Second, Trusts '181*] 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.

7.1.1.3.13 **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.

7.1.1.3.14 **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.

7.1.1.3.15 **The Duty to Investigate the Acts and Omissions of Predecessor Fiduciaries:** [*American Law Institute, Restatement of the Law, Second, Trusts '223*] 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 instruments.

7.1.1.4 **Modification of Fiduciary Duties:** 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.

While fiduciary duties may be modified or waived, in order to modify or waive a fiduciary duty, the instrument should specifically and explicitly mention the fiduciary duty (or the acts or omissions that are being authorized) and the extent to which it is modified or waived. *Langford v. Shamburger*, 417 S.W.2d 438 (Tex. App. B Ft. Worth, 1967); *Furr v. Hall*, 553 S.W.2d 666 (Tex. App. B Amarillo, 1977) Additionally, there are public policy restrictions on the extent that certain fiduciary duties may be waived.

While individual fiduciary duties may be modified, a trustee may not be relieved of all fiduciary duties. The American Law Institute, *Restatement of the Law, Second, Trusts 2d '25* provides that: A trust is created unless the settlor manifests an intention to impose enforceable duties. @

7.1.1.4.1 Statutory Fiduciary Duties: The Texas Trust Code specifically authorizes the modification of statutory fiduciary duties. This authorization is contained in Tex. Trust Code '113.058(a) (A Except as provided by Subsection (b) of this section, the settlor by provision in an instrument creating, modifying, or revoking the trust may relieve the trustee from a duty liability or restriction imposed by this subtitle @). There are statutory limitations on the extent that an instrument can relieve a trustee of his statutory fiduciary duties. Tex. Trust Code '113.058(b) (a settlor may not relieve a corporate trustee from the duties, restrictions, or liabilities of Section 113.052 (relating to the loan of trust funds to a trustee), and 113.053 (relating to the purchase or sale of trust property by a trustee).

It is important to note that violation of statutory fiduciary duties usually results in strict liability on the trustee.

7.1.1.4.2 Common Law Fiduciary Duties: Subject to the limitations set forth below, common law fiduciary duties may be waived or modified.

7.1.1.4.2.1 **Fairness:** Even if the fiduciary duty is modified or waived, it can not authorize the fiduciary to participate in a transaction that is unfair to the distributee. For example, an instrument can authorize a non-corporate trustee to sell Black Acre to himself. This does not mean that the trustee may purchase Black Acre for \$1, if it is, in fact, worth \$100,000.

If the trustee purchases Black Acre he will invoke the so-called constructive fraud doctrine that will cause the transaction to be presumed unfair to the distributees unless the trustee can prove otherwise.

The more complicated issue is the enforceability of a provision that a fiduciary may purchase Black Acre for \$1.00 (when Black Acre is actually worth \$100,000). It is the author=s opinion that this type of provision would be enforceable (and would not constitute constructive fraud) because the fiduciary was not given discretion to determine the price at which he purchases Black Acre.

7.1.1.4.2.2 **Public Policy Limitations:** There are public policy limitations on the extent to which an instrument may relieve a fiduciary of fiduciary duties. There is very little case law dealing with the public policy limits on the waiver of the fiduciary duties of an executor or administrator (it is the author=s view, however, that the same public policy limitations would apply to the personal representatives of estates that apply to trustees of trusts). The language of and instrument can not authorize: (1) self dealing¹, (2) any situation in which the trustee uses his position of trust to obtain an advantage by action inconsistent with the trustee=s duties and detrimental to the trust, (3) actions taken in bad faith, or (4) for acting intentionally adverse to the interests of the distributee. *Interfirst Bank Dallas, N.A. v. Risser*, 739 S.W.2d 882 (Tex. App. B Texarkana,

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Risser, supra, at 898 explains that the earlier Texas trust cases involving breaches of fiduciary duty did not use the term *self-dealing*; nor did the cases make a clear distinction between self-interest which was a statutory violation, as opposed to a conflict of interest situation.

1987).[American Law Institute, Restatement of the Law, Second, Trusts '222]

7.1.1.4.3 **General Grants of Fiduciary Powers Do Not Waive or Modify Fiduciary Duties:** A broad grant of power does not normally waive any fiduciary duties. For example, the language I give my fiduciary the same power to buy and sell fiduciary property as a fee simple owner@ gives the fiduciary broad power to deal with the fiduciary estate but it probably does not relieve a fiduciary of any of his fiduciary duties (especially the duty of loyalty). *Furr v. Furr*, 553 S.W.2d 666, 672 (Tex. Civ.App. - Amarillo 1977).

7.1.1.4.4 **Exculpatory Clauses Do Not Waive Fiduciary Duties:** An exculpatory clause in a will or trust does not usually modify or waive any fiduciary duties. It merely protects the fiduciary from monetary liability for breach of the duty. A trustee may be removed or be forced to forgo his trustee=s fee for breaching a fiduciary duty even if there is an exculpatory clause. See *Fletcher, Scott on Trusts, Fourth Edition*, '222.1 (Distinction between exculpatory provisions and those enlarging the trustee=s powers) But also see *Jochev v. Clayburne*, 863 S.W.2d 516 (Tex. App. B Austin 1993)

7.1.2 **Executor=s Powers:** In a will the executor can 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 distributees during the administration of the decedent's estate.

7.1.3 **Special Assets:** Special concern should be given to the ability of the fiduciary to retain and administer unproductive assets (a lesser included element of the duty of prudence). Special assets may include equity in the family business, a vacation home, the family farm or ranch and similar assets that may not appreciate or earn income but that the person executing the will or wishes for the the fiduciary to retain.

- 7.1.4 **Special Relationships:** If a testator or settlor has a special relationship with the person he or she is appointing as fiduciary (*i.e.* such person is a spouse, close friend or close relative) then exculpation (and/or modification of fiduciary duties) should be considered. This is especially true if the fiduciary is not receiving compensation for his or her services. Modification of the fiduciary duty of loyalty should be considered in this situation.
- 7.1.5 **Prohibited Transactions:** As many prohibited transactions as possible should be specifically set forth in the instrument. If they are, then the distributee will be less likely to misinterpret the purpose of the trust or the powers of the fiduciary.
- 7.1.6 **Impartiality:** 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 distributees should be given priority over remaindermen; and whether living distributees should be given priority over unborn or unknown distributees.
- 7.1.7 **Investigation of Prior Acts:** 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.
- 7.1.8 **A Word Of Caution: The procedures for modification of fiduciary duties and the public policy limitations on modification of fiduciary duties (especially the duty of loyalty) have not been clearly articulated by the Texas appellate courts. If one were to guess where the Courts are going it would be: (1) that in order to modify or revoke a fiduciary duty the testator or settlor must, by specific language in the instrument, identify either the duty to be modified or the transaction to be authorized and the extent that the duty is modified; and (2) 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.**
- 0.1 **Avoid the Trustee-Distributee Combination:** If the only concern is with the relationship of a trustee (who is also a distributee) with another distributee, then such trust distributee 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/distributee is usually the surviving

spouse. Many times, children are used as trustees 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 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.

7.1.9 **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.).

7.1.10 **Reliance:** 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. 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).

7.1.11 **Impartiality:** If a distributee 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 distributees. Any discretionary fiduciary decision that results in a distribution of principal or income to the distributee who is serving as trustee has the potential of being violative of the duty of impartiality.

7.1.12 **High Risk of Litigation:** It is especially dangerous to appoint a distributee 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 surviving spouse has descendants by a prior marriage and the decedent has descendants. Another dangerous situation is created when a sibling-distributee 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.

0.2 Draft an Explicit Purpose Clause: Many trusts should have an explicit purpose clause. Few 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 distributees 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.

0.3 Anticipate Environmental Problems

0.3.1 The Clauses:

0.3.1.1 **AExecutor=s Environmental Powers:** 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 executor qualifies as my personal representative he shall be reimbursed from my estate for all expenses incurred in connection with such inspection."

"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."

0.3.1.2 **"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 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."

0.3.1.3 **ADefinitions:** 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."

0.3.1.4 **"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."

0.3.2 **Validity of the Clause:** The author has no reason to believe that these clauses are not valid. There is no Texas authority specifically allowing this type of clause. There are special provisions in the Texas Trust Code limiting a trustee=s liability for environmental litigation. See Tex. Trust Code '113.025.

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

0.4 Define the Interrelationship Between Co-Fiduciaries: The appointment of multiple fiduciaries should usually be avoided. If it is unavoidable, then follow the guidelines below.

7.1.13 Multiple Executors: 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.

7.1.14 Multiple Trustees: 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.

7.1.15 Fiduciary Participation: 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 should be drafted in such a manner as to clearly spell out the respective powers and duties of each fiduciary. The 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.

0.5 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.

- 0.5.1 **Support Trust:** A support trust contains a defined distribution standard and allows a distributee 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 distributee.

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

- 0.5.2 **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 trust is a discretionary trust, then the distributee 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, The Law of Trusts and Trustees*:

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 distributee, 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 distributee 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 distributee 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 distributee. The trustee must have complete discretion to pay or apply or to totally exclude the distributee, 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 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:

8. the extent of discretion conferred;
9. the existence of a definable external standard by which the reasonableness of the trustee can be judged;
10. if such a standard exists, the due diligence the trustee used to obtain the facts necessary to comply with this standard;

11. the circumstances surrounding the decision;
12. the factors that the trustee considered in making the decision;
13. the motives of the trustee; and
14. 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).

7.2 **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 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.

0.6 **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.

0.7 **Avoid the Word "Reasonable:"** 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.

FIDUCIARY PROTECTION CLAUSES

8.1 **Exculpatory Clauses.**

0.7.1 **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."

- 0.7.2 **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*, 846 S.W. 2d 70- (Tex.App.- Corpus Christi 1993); *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.). There are also 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 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 distributee...

0.7.3 **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.

8.1.1.1 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?

8.1.1.2 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 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.

8.1.1.3 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).

8.1.1.4 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).

0.8 **In Terrorem Clauses.**

0.8.1 **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 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 Fiduciary²**; 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), 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) 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 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

² While language of this type is sometimes found in *In Terrorem* clauses, it is the author's opinion that this type of provision would be void as against public policy. If a distributee can not enforce the trust (or sue the trustee) then there are serious questions regarding whether a trust exists.

_____, 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. 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."

- 0.8.2 **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. 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.

- 0.8.3 **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.

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 which, in theory, prevents the contestant from filing a lawsuit. I have seen wills containing *In Terrorem* provisions that leave a potential litigant only one 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.

0.9 Legal Expense Clauses.

0.9.1 **The Clause:** "My Fiduciary shall have the right and power, without prior Court approval, to obtain interim 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 interim 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. "

0.9.2 **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.

0.9.3 **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.

0.10 **Consider the Use of an Arbitration Clause:** 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 distributee 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 non-binding mediation can be extremely helpful in settling disputes or, at the least, narrowing the issues for trial.

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 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 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.

CONCEPT CLAUSES

(WE AREN'T IN KANSAS ANYMORE)

- 0.1 A Word Of Caution.** The clauses that follow have been drafted in response to several issues that frequently arise in fiduciary litigation. They constitute a "wish list" of clauses the author would like to see in an instrument in fiduciary litigation 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.
- 0.2 Imposed Limitation of Actions.**
- 0.2.1 **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 basis for any such cause of action."
- 0.2.2 **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 distributee forfeits his or her interest in the estate or trust if he or she institutes any cause of action after such time.
- 0.3 Virtual Representation.**
- 0.3.1 **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 distributees 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 distributees designated as a class or unascertained distributees as if such persons were living and a party to the proceeding at the time the judgment, order, or decree was entered."

- 0.3.2 **Use of the Clause:** The fees of attorney 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.

0.4 Recognition of Virtual Representation.

- 0.4.1 **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 (except for any legal proceeding involving the personal liability of my Fiduciary). 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.

0.5 Imposition of Legal Fees on Unsuccessful Litigants.

- 0.5.1 **The Clause:** Alf 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."

- 0.5.2 **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.

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.

0.6 **Elimination of Derivative Causes of Action.**

- 0.6.1 **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 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."

0.6.2 **Use of the Clause:** Many causes of action are brought 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.

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.

0.7 Waiver of Conflict of Interest Between the Attorney Representing My Estate or Trust and the Attorney Defending My Fiduciary.

0.7.1 **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. No 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."

0.7.2 **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.

ADDITIONAL MATERIALS TO CONSIDER

10.1 The author also recommends the following articles:

10.1.1 *Drafting Specific Will and Trust Clauses B Non-Tax Considerations*, Noel C. Ice; Advanced Drafting: State Bar of Texas, Estate Planning and Probate Course, Houston, Texas November 11-12, 1993; and

10.1.2 *What They Don=t Teach You In Form Books*, Jon J. Gallo and Anne K. Hilkner; Advanced Drafting: State Bar of Texas, Estate Planning and Probate Course, Houston, Texas November 11-12, 1993.