

## **TEN THINGS THAT EVERY TRUST BENEFICIARY IN TEXAS SHOULD KNOW**

**INTRODUCTION:** We have specialized in estate planning, probate, guardianship and trust law for over forty five years. For the past fifteen years our firm's practice has concentrated on trust administration and litigation.

Over this period of time we have been involved in countless controversies involving trusts. The vast majority of the beneficiaries that initially come to us complaining of their trustee's acts or omissions have the same complaints. In many situations the beneficiaries appear to be somewhat overwhelmed regarding exactly what their rights and remedies are.

In most cases the beneficiary is not being provided with sufficient information about the administration of his or her trust and/or they believe that their trustee is using his or her office as trustee to benefit himself or herself at the beneficiaries expense.

The following information will hopefully be helpful in explaining exactly what a beneficiaries rights are. We should stress, however, that there are many nuances of trust litigation that are not covered by this paper – this is just a starting point.

Let's start with the basics. Let's explore exactly what a trust is and how trust accounting works. There are numerous kinds of trusts: (1) inter vivos trusts or living trusts, which are trusts created by living persons, (2) testamentary trusts, which are trusts created in a deceased person's will, (3) revocable trusts, which are trusts that may be modified or revoked by the person creating them, (4) irrevocable trusts, which are trusts that may not be modified or revoked by the person creating them, and (5) numerous kinds of tax motivated trusts. Testamentary trusts are usually irrevocable. Inter vivos trusts can be either revocable or irrevocable.

A trust is not a legal entity in Texas. It is a relationship whereby a trustee acts as the agent for two classes of beneficiaries, income beneficiaries and remainder beneficiaries. Income beneficiaries are the persons entitled to receive income (and sometimes principal) from the trust while it is being administered. Remainder beneficiaries are the persons entitled to receive the principal (and sometimes accumulated undistributed income) from the trust upon termination. There is an inherent conflict between these two classes of beneficiaries and, absent contrary provisions in the trust instrument, a trustee has a fiduciary duty to treat them impartially.

You should be aware that the information set forth below is general information that applies to most trusts in Texas. You should, of course, seek specific legal

advice with respect to your specific trust. This is especially true if you are a beneficiary of a revocable trust. Some of the observations set forth below do not apply to revocable trusts.

1. **READ THE TRUST INSTRUMENT:** No beneficiary should be expected to understand all of the provisions of the trust instrument. Generally, provisions in the trust instrument overrule contrary provisions in the Texas Trust Code, there are, however, exceptions to this rule. That is, there are provisions of the Texas Trust Code that overrule contrary provisions in the trust instrument. It is not important to know what all of these are, but it is important to know that exceptions exist.

The most basic things that a beneficiary should learn from reading the trust instrument are: (1) who is the trustee, (2) who are the income beneficiaries of the trust (3) who are the remainder beneficiaries of the trust and (3) if the beneficiary is an income beneficiary, what is the distribution standard? It is fairly simple to ascertain who the trustee, the income beneficiaries and remainder beneficiaries are. The distribution standard is another matter and is dealt with below.

2. **TRY TO UNDERSTAND THE DISTRIBUTION STANDARD IN YOUR TRUST:** You should try to understand the distribution standard in your trust. The distribution standard is the language that sets forth the criteria under which the trustee is authorized to distribute income (and sometimes principal) to the income beneficiary.

While distribution standards vary greatly from trust to trust there are two general types of distribution standards: (1) a "purely discretionary" distribution standard and (2) a distribution standard governed by an "ascertainable standard".

Purely discretionary distribution standards are fairly rare. A typical discretionary distribution standard might read: "my trustee is authorized to distribute to A such amounts of the income and/or corpus of the trust as he shall elect in his absolute and unqualified discretion." Within certain limitations the amount that A receives is in the total discretion of the trustee. While it is difficult to litigate this type of standard you should know that there is no such thing as "absolute discretion" in Texas. A trustee can either fail to exercise discretion or abuse his discretion. These concepts are complicated and require the advice of an attorney specializing in this area of the law.

Ascertainable distribution standards are frequently used in trust instruments. The most frequently used ascertainable distribution standard is what is

commonly referred to as a “HEMS” standard. HEMS stands for “health, education, maintenance and support.” A typical HEMS standard distribution standard might read: “my trustee is authorized to distribute to A such amounts of the income and/or corpus of the trust as may be necessary to provide for A’s health, education, maintenance and support.”

Sometimes drafters will try to blend discretionary and HEMS distribution standards. This type of standard might read: “my trustee is authorized in his absolute and uncontrolled discretion to distribute to A such amounts of the income and/or corpus of the trust as may be necessary to provide for A’s health, education, maintenance and support.” This is basically just a HEMS standard despite the “absolute and uncontrolled discretion” language.

Distribution standards frequently mandate that the trustee take into consideration assets and/or income available to the income beneficiary from other sources.

This is complicated stuff. We recommend that an income beneficiary consult with an attorney specializing in this area and try to understand, to the greatest extent possible, how the distribution standard in his or her trust works. A basic understanding of the distribution standard will help shape a beneficiaries expectations regarding what he or she should be distributed from the trust and what information to give the trustee when making requests for income.

Remainder beneficiaries also need to have a basic understanding of the distribution standard to insure that their trustee is not making excessive or unwarranted distributions to the income beneficiary.

3. **YOUR TRUSTEE HAS A DUTY TO DISCLOSE INFORMATION TO YOU:** Your trustee has a duty to disclose to you all material facts, known to him which might affect your rights as a beneficiary. This duty manifests itself in two ways: (1) there is information that a trustee is required to disclose to a beneficiary regardless of whether or not the beneficiary asks for it and (2) there is information that a trustee is required to disclose to the beneficiaries in response to a specific request from the beneficiary for the information.

**UNREQUESTED INFORMATION:** While it is difficult to categorized everything that a trustee is required to disclose regardless of a request by a beneficiary there are some fairly obvious examples: the existence of the trust, a copy of the trust instrument, the beneficiaries right to receive income and/or principal from the trust, material facts regarding any transaction in which the trustee has a personal interest, material facts regarding any transaction whereby the

trustee uses his fiduciary office to obtain any personal benefit or profit, and any breach of trust by the trustee.

**REQUESTED INFORMATION:** Subject to the limitations set forth below, a trustee has a duty to furnish the beneficiary almost any information regarding the trust that is requested by the beneficiary. For example, if you were to ask your trustee for a list of assets that the trust estate is invested in, the trustee is required to give you this information.

While the law is not clear, there are limitations on a trustee's duty to disclose information. It is our opinion that a trustee probably does not have to disclose the following information (regardless of whether or not such information is requested by the beneficiary): (1) disclosure of confidential medical information regarding other beneficiaries, (2) disclosure of information to a beneficiary who has a personal interest in a trust transaction (especially if his or her interest is adverse to the trust), (3) disclosure that would violate any state or federal law, (4) disclosure of information relating to communications between a trustee and his lawyer, (5) disclosure of personal information regarding the trustee that does not relate to his or her administration of the trust, (6) disclosure of facts that do not affect the beneficiary's rights, and (7) disclosure of burdensome, harassing or duplicative requests for information.

The law is also not well settled as to who has to pay the trustee's expenses in obtaining, compiling, copying and dissemination of the information requested. It is my experience that most routine requests will be paid for out of the trust estate of the trust.

The bottom line is that you should never be hesitant to request information regarding your trust from your trustee. If your trustee refuses to provide you with information should consider retaining an attorney to compel him to comply with the law.

**4. YOUR TRUSTEE HAS A DUTY TO PROVIDE YOU WITH AN ACCOUNTING:** One thing that beneficiaries should be generally aware of is the fundamentals of trust accounting. Trust accounting has nothing whatsoever to do with generally accepted accounting principles ("GAAP") which most CPA's practice, it is governed by statutory provisions in the Texas Trust Code (which may be modified by provisions in the trust instrument). The intricacies of trust accounting are very complex and are not something that most trust beneficiaries need to know. Knowledge of the fundamentals, however, is important.

Trust accounting rules allocate all trust receipts (property or income coming into the trust estate) and all trust disbursements (payments out of the trust estate) between an income account and a principal (or "corpus") account. The income account is the source of distributions to the income beneficiaries during the term of the administration of the trust. In certain situations a trustee may be also authorized to make distributions of principal to the income beneficiary during the administration of the trust. Finally, the principal account is the source of distributions to the remainder beneficiaries upon termination of the trust. If there is undistributed accumulated income on hand at the termination of the trust this will also be distributed to the remainder beneficiaries.

Trustees' are therefore required to maintain two accounts, an income account and a principal account. Our experience teaches that corporate trustees maintain proper trust accounting records as a matter of course and that individual trustees seldom if ever maintain proper trust accounting records.

Many trust instruments contain provisions requiring a trustee to periodically account to a beneficiary. You should carefully look for such a provision when you read the trust instrument. In Texas, if the instrument does not require your trustee to provide you with periodic accountings then the trustee is not required to do so absent a request from you.

You always have the right to demand a statutory trust accounting from your trustee. If your trustee fails to provide you with a statutory trust accounting within 90 days after the date that he, she or it receives your demand, then you can file an action in court to compel him to comply with your demand.

In such an action the court will determine whether or not your interest in the trust is sufficient to require an accounting. If you are a current income beneficiary or the person designated to receive a portion of the trust on termination then you will almost always prevail in the action and the court will order the trustee to account. If you prevail in the action the court can, but is not required to, order that the trustee pay all of your attorney's fees and costs out of his personal assets. It is our experience that this frequently happens.

The contents of a statutory trust accounting are set forth in the Texas Trust Code. Such trust accounting must show: (1) all trust property that has come to the trustee's knowledge or into the trustee's possession, (2) a complete account of receipts, disbursements, and other transactions regarding the trust property for the period covered by the account, including their source and nature, with receipts of principal and income shown separately, (3) a

listing of all property being administered with an adequate description of each asset, (4) the cash balance on hand and the name and location of the depository where the balance is kept, and (5) all known liabilities of the trust.

A beneficiary may demand a statutory trust accounting once a year but not more frequently unless specifically ordered by the court.

5. **YOUR TRUSTEE HAS A DUTY TO ALLOW YOU TO EXAMINE AND COPY THE BOOKS AND RECORDS OF THE TRUST:** Your trustee is required to maintain full, accurate and orderly records concerning the status of the trust and of all acts that he or she performs as your trustee.

You and your agents (such as attorneys or accountants) have an legal right to examine the books and records of the trust at reasonable times and to copy any such books and records at your expense. There are some limitations on what books and records that your trustee has to provide. These are virtually the same as the limitations on disclosure of information set forth in Paragraph 3 above.

6. **YOUR TRUSTEE HAS A FIDUCIARY DUTY TO PUT YOUR INTEREST BEFORE HIS OWN:** Your trustee has a fiduciary duty of loyalty that prevents him from using his office as your trustee to obtain any benefit for himself personally. Your trustee is entitled to a reasonable trustee's fee for serving as your trustee. Your trustee is generally not entitled to receive any "profit" from serving as your trustee.

In the absence of specific authorization in the trust instrument, your trustee may not loan trust funds to himself or herself, to an affiliate, officer, or employee of the trustee or his or her affiliate, to a relative, to his or her employer, employee, partner, or other business associate.

In the absence of specific authorization in the trust instrument, your trustee may not buy or sell trust property from or to himself or herself, to an affiliate, officer, or employee of the trustee or his or her affiliate, to a relative, to his or her employer, employee, partner, or other business associate.

In the absence of specific authorization in the trust instrument, your trustee may not sell property to another trust of which he or she is the trustee unless the property is a bond, note, bill, or other obligation issued or fully guaranteed as to principal and interest by the United States; and is sold for its current market price.

The law involving self-dealing by a trustee is very complex and way beyond the scope of this paper. The point is that, if you suspect that your trustee is receiving any kind of personal benefit (other than his or her trustee's fee) from his administration of your trust – you should consult with an attorney.

7. **YOU SHOULD PERIODICALLY REVIEW THE PERFORMANCE OF YOUR TRUST:** You should request that your trustee provide you, at least annually, the following information: (1) the percentage of increase or decrease in the value of the trust estate of the trust during the last year, (2) the total amount of trustee's fees that have been charged against the trust estate of the trust during the last year.

Most beneficiaries do not have the background, knowledge, or education to intelligently analyze each investment decision that his or her trustee makes. Frequently, the financial information that trustees provide beneficiaries does not make sense or is very hard to interpret. A beneficiary should, however, keep up with the performance of his or her trustee in at least general terms. For this reason I suggest requesting the information set forth above.

8. **YOU SHOULD NEVER GIVE YOUR TRUSTEE A RELEASE OR INDEMNITY WITHOUT CONSULTING WITH AN ATTORNEY:** Trustees (especially corporate trustees) will frequently request that a beneficiary to sign a release and/or indemnity upon the termination of the trust and prior to making the final distribution. Their pitch is that if you sign the release then you will save the cost of the trustee going to court and obtaining a settlement of his final accounts. Many beneficiaries, relying on their trustees, sign the release or indemnity that is given them in order to receive their final distribution.

A release is a contract whereby one person agrees not to hold another person liable for certain acts and omissions. A release may read: "A releases B from any claims or causes of action for serving as trustee".

In Texas a beneficiary cannot normally release his or her trustee for liability for acts or omissions that have not been disclosed by the trustee to the beneficiary or for breaches of fiduciary duty occurring in the future. The release that many trustees present to beneficiaries frequently purport to release the trustee for unknown and/or sometimes future acts. In my opinion this constitutes self-dealing by the trustee.

An indemnify is a contract whereby one person agrees to reimburse another person for all cost, loss, expense and liability the other person may incur if they are sued. An indemnity may read: " A indemnifies B from any loss, cost, expense or liability resulting from a lawsuit by C."

A beneficiary should NEVER sign an agreement indemnifying his or her trustee. If you are asked to sign an indemnity then you should probably consult with an attorney that specializes in this area because your trustee is engaging in a self-dealing transaction. If your trustee is seeking an indemnity he, she or it is probably also asking you to sign an overreaching release.

What do you do to avoid having your trustee go to court and incur the cost of having its final accountings settled? First, the threat of going to court is usually a bluff. Trustees rarely go to court because they never know what will happen if they do. Second, you should agree to release your trustee for any and all acts and omissions that have been "fully and fairly" disclosed to you. You will probably need to hire an attorney to conduct these negotiations.

The bottom line is that a "fully and fairly" disclosed release (discharge) is all that a trustee can ever get in court. A court can neither discharge a trustee from unknown, undisclosed or future claims and causes of action and can never give a trustee an indemnity. When a trustee rejects a full and fair release and goes to court, it becomes susceptible to the argument that the trustee should pay all costs and attorney's fees for the discharge because it could have gotten a release without going to court.

9. **YOU SHOULD NEVER BE AFRAID OF AN EXCULPATORY CLAUSE:** Many beneficiaries have concerns about provisions in the trust instrument purporting to limit or eliminate the trustee's liability for breach of trust (Exculpatory Clauses). The Texas Trust Code provides that, regardless of contrary provisions in the trust instrument, a trustee is always liable for failing to act in good faith, for failing to act in accordance with the purposes of the trust, for intentionally committing a breach of trust, or for committing a breach of trust with reckless indifference to the interest of a beneficiary.

So, regardless of what the trust instrument provides, if you believe that your trustee has committed any of the acts described above, you may have a cause of action against your trustee regardless of any limits on liability contained in the trust instrument.

10. **YOU SHOULD RETAIN AN ATTORNEY WHO SPECIALIZES IN THIS TYPE OF LITIGATION:** It is very important to understand that the perspective and expertise of a fiduciary litigator is very different from that of a business litigator, a general practitioner, or even an estate planning attorney.

Fiduciary litigation is a very complex area of the law. Fiduciary litigation involves specialized knowledge in the elements of fiduciary duties and their

breach, the often shifting of the burden of proof, and the damages and other remedies that are available in the event of a breach of fiduciary duty.

If you have a routine question about interpreting a trust then an estate planning lawyer will usually have the expertise to help you. If you are considering fiduciary litigation you should hire an attorney who specializes in fiduciary litigation. Most estate planning attorneys do not do fiduciary litigation. If hired to sue a trustee they will most frequently refer the matter to a general litigator in their law firm. This is usually not in your best interest for the following reasons: (1) the general litigator will have to either do extensive research on fiduciary liability or participate in extensive consultation with the estate planning attorney (who can interpret the trust but has little knowledge or experience in fiduciary litigation).

If you are interviewing an attorney to represent you in connection with a suit against your trustee you should ask the attorney two questions: (1) what percent of his practice consists of fiduciary litigation and (2) how many trust litigation cases has he handled in the last year. If his answers disclose that he does not specialize in this area you should seek other counsel.

One final thought, while our law firm specializes in fiduciary litigation in general and trust litigation in particular we are by no means alone. There are numerous very good law firms in Texas that specialize in this area.