AVOIDING
FIDUCIARY LITIGATION

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DRAFTING TO AVOID WILL CONTESTS AND FIDUCIARY LITIGATION

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PRELIMINARIES

Introduction

My discussion of clauses to protect the fiduciary is divided into two parts. They are AWill Contest Considerations, "Fiduciary Protection Clauses"

Will Contest Considerations relate to estate planning techniques to avoid will contests in situations where such a contest is anticipated. This part deals primarily with the most frequently encountered problem area C the situation where the client has a second spouse and one or the other of the spouses have children by a prior marriage.

Fiduciary Protection Clauses are the clauses that expressly relieve a fiduciary from fiduciary liability or inhibit a distributee's ability to prosecute fiduciary litigation. This section is further divided into three subparts: A**General Drafting Considerations@** A**Special Protection Clauses**@ and A**Concept Clauses**@.

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

Special Protection 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.

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

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

A. Fiduciary shall refer to any personal representative of an estate, to any trustee of any trust created under a will, or to any other person, firm or corporation given fiduciary powers or duties under a will.

B. Distributee shall refer to any distributee under a will as well as any beneficiary of any trust.

C. Fiduciary Attorney shall refer to the attorney or law firm representing a fiduciary in connection with the administration of an estate or any trust.

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

Revise the rest of this paper to conform to the preface (above).

I. GENERAL DRAFTING CONSIDERATIONS

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

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

In a will the executor will sometimes be given both the powers and the duties of the trustee. There is, however, some difference of opinion on this subject. Some commentators believe that because the executor's job is only to administer the decedent's estate as rapidly as possible, the executor should not be given the powers of the trustee. The existence of such powers may delay the closing of the administration of the estate. Thought should be given to the extent the executor is authorized and/or instructed to make distributions to trust beneficiaries during the administration of the decedent's estate.

If special assets are involved, then consideration should be given to modifying the duty of prudence to provide specifically for the retention, management and

reinvestment of these assets. Examples of this type of assets are: closely held corporate stock, partnership interests, a family business, the family homestead, a family farm, a weekend resort residence.

If a fiduciary has a special relationship to the person appointing the fiduciary (*i.e.* such person is a spouse, close friend or close relative), then exculpation should be considered. This is especially true if the fiduciary is not receiving compensation for his or her services. The fiduciary duty of loyalty may only be partially waived. To the extent that it can be waived, it should be considered in this situation.

Prohibited transactions should be specifically described in the instrument. If they are, then the beneficiary will know, for example, that he or she may not borrow from the trust; at least not without the necessity of having several attorneys render legal opinions on the matter.

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

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

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

Texas Trust Code Section 113.051 provides that:

> The trustee shall administer the trust according to its terms and this subtitle. In the absence of any contrary terms in the trust instrument or contrary provisions of this subtitle, in administering the trust the trustee shall perform all of the duties imposed on trustees by the common law.

Texas Trust Code Section 113.059 provides that:

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

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

(c) A Settlor may not relieve the trustee of liability for:

(1) a breach of trust committed:

(A) in bad faith;

(B) intentionally; or

(C) with reckless indifference to the interest of the beneficiary; or

(2) any profit derived by the trustee from a breach of trust.

(d) A provisi0n in a trust instrument relieving the trustee of liability for a breach of trust in ineffective to the extent that the provision is inserted in the trust instrument as as result of an abuse by the trustee of a fiduciary duty to or confidential relationship with the settlor.

The Texas Supreme Court in the case of Texas Commerce Bank, N.A. v. Grizzle, 96 S.W.3d 240 (Tex. 2002) has strictly construed this statute.

B. Avoid the Trustee-Beneficiary Combination. If the only concern is with the relationship of a trustee who is also a beneficiary to another beneficiary, then a trust beneficiary should never be made a trustee. However, the tax laws often dictate the use of trusts in estate planning situations (*e.g.,* the bypass trust to save taxes at the second death) and the logical trustee/beneficiary is usually the surviving spouse. Many times, children are used as trustee of a generation skipping trust. This is not to say that such situations are free of conflicts of interest. Indeed, conflicts are built in, and those conflicts permeate almost every fiduciary duty of a trustee. The testator or settlor should be advised of these problems, but family and tax considerations will often cause clients to take the risk of such built-in conflicts. It is the attorney's duty to insure that the client understands the potential problems. However, the desire of the fiduciary law purist will often be overridden by more practical concerns.

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

The constructive fraud doctrine provides that if a fiduciary takes any discretionary action as a fiduciary which directly or indirectly benefits the fiduciary (or the fiduciary's family or affiliates) then the transaction is presumed fraudulent. The burden of proof then shifts to the fiduciary to prove that the transaction is fair. In any transaction where a person benefitting 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 unrebutted, and the transaction is invalid as a matter of law. ***Texas Bank and Trust v. A. E. Moore***, 595 S.W.2d 502 (Tex. 1980). Because the burden of proof in this cause of action is shifted to the defendant, it is distinguishable from other types of "constructive fraud" in which the entire burden rests on the party asserting it. ***Miller v. Miller***, 700 S.W.2d 941 (Tex. App.--Dallas 1985, writ ref=d. n.r.e.).

It is clear that under Texas law a plaintiff is not required to show that he relied upon the defendant to discharge his fiduciary duties in order to assert a claim of constructive fraud successfully. ***Johnson v. Peckam***, 120 S.W.2d 786, at 788 (Tex. 1936). In ***Johnson,*** the Supreme Court held that the trial court had not erred in refusing to submit a special issue to the jury which called upon it to determine whether or not the plaintiff had relied upon his partner to make certain disclosures to him concerning negotiations for the sale of partnership property. As the court noted, a fiduciary is under an absolute duty to carry out the responsibilities of his position and, therefore, reliance by the plaintiff is not necessary to establish constructive fraud. See Carl David Adams, "Benefitting From Fiduciary Office: A Presumption of Fraud," 47 Tex. B.J. 648 (1984).

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

It is especially dangerous to appoint a beneficiary as trustee in family situations where there is a high potential for litigation. The most obvious example of this is the situation is where the surviving spouse has descendants by a prior marriage and the decedent has descendants. Another dangerous situation is created when a sibling-beneficiary is appointed as the trustee of a trust where other siblings are permissive distributees.

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

C. 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 beneficiaries have a clear understanding of the purposes of the trust, they are less likely to litigate than if the purpose of the trust is left to surmise and conflicting interpretation.

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

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

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

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.

E. 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.

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

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

Support distribution standards should be drafted as precisely as possible. They should specifically outline all of the criteria that the trustee is to consider; the relative importance of each member of the class of permissive distributees; any differences in criteria that should apply to principal distributions (as opposed to income distributions); and specify the manner 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.

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

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

A settlor may provide that his trustee shall have absolute and uncontrolled discretion whether to pay or apply trust income or principal to or for the benefit of a named beneficiary, without fixing any standard or guide which the trustee is to consider, and that the income which the trustee does not elect to use for the beneficiary shall be accumulated or paid to another or to a class of other persons. Such a trust has been called a "discretionary trust" and this term has a technical meaning for the purpose of determining the rights of the beneficiary and his assignees and creditors. It must be distinguished from trusts where the discretion of the trustee pertains only to the time or manner of the payments, or to the size of the payments needed to achieve a certain purpose, for example, to support the beneficiary. The trustee must have complete discretion to pay or apply or to totally exclude the beneficiary, if the trust is to be called "discretionary" in a technical sense.

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

a. the extent of discretion conferred;
b. the existence of a definable external standard by which the reasonableness of the trustee can be judged;
c. if such a standard exists, the due diligence the trustee used to obtain the facts necessary to comply with this standard;
d. the circumstances surrounding the decision;
e. the factors that the trustee considered in making the decision;
f. the motives of the trustee; and
g. 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).

F. 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.

G. 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.

H. 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.

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

> Any will or trust you draft will be read by your client, his family, the executor, the trustee, any distributees or beneficiaries and their attorneys. In today's legal climate it is not unlikely that it will also be read by a judge and a jury. In any event, always remember that the majority of your audience will not be lawyers. When you draft a will or a trust concentrate on using "plain English." The document should not be so complicated that only another estate planner can understand it. While I realize this is easier said than done, it may help if you try to visualize the typical jury that could end up being the final critic of your work. If you can express your ideas in a way that this group of lay persons can readily understand what you intended to say then you are truly an "advanced estate planner." Even though the makeup of jury panels will vary considerably from one part of the state and country to the next, there are certain traits in common in the majority of panels that may be helpful to consider:
>
> (a) Expect no more than a high school education; hope they all speak English fluently;
>
> (b) On average, anticipate that they will earn approximately $15,000 to $25,000 per year;
>
> (c) Realize that most jurors will not need or have sophisticated estate plans or trusts of their own, and may not like anyone who does;

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

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

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

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

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

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

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

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

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

(m) If they can't understand what you wrote they will make up what they think is fair;
(n) Most of the time they will do what is right in spite of the most sophisticated attempts to draft language exculpating the fiduciary.

The best way to "jury" test your product is to have your secretary or your receptionist read the document and then tell you what they understood or didn't understand. Be careful when you "cut and paste," the accidently dropped line or word can create significant problems. Also, be sure to re-read your "boilerplate" language every time you use it. What may have made good sense two years ago may not seem so clear today.

II. WILL CONTEST CONSIDERATIONS

A. Background. We all encounter estate planning situations where there is a higher than normal risk of a will contest. These situations include:

1. THE SECOND MARRIAGE: Multiple marriages present a high potential for will contests. This is especially true if: (a) one spouse has a significantly larger estate than the other spouse; (b) one or more of the spouses has descendants by a prior marriage; and/or (c) there is a significant age difference between the spouses.

The spouse with the larger estate (the AAlpha Spouse@) will frequently want to provide for his or her spouse (the ABeta Spouse@) for the remainder of his or her life. This invariably causes resentment by the descendants of the Alpha Spouse.

2. FAMILY ESTRANGEMENT: When a family member has a history of animosity toward a client, there is the potential for a will contest. This potential also exists when members of a class of potential distributees have a lifetime history of hostility (i.e. two or more of the client=s children are estranged from each other). Many clients choose to ignore this problem and appoint estranged family members as co-executors of their estates.

3. UNEQUAL DIVISION OF THE ESTATE: When a client desires to disinherit a person who would otherwise be an object of his or her bounty there is a high potential for a will contest. This is also true when a client desires to make an unequal division of his or her estate among his or her descendants.

4. GREED: Greed is a stronger force than gravity. If the client=s estate is very large, there is always the potential for a will contest. In this situation, the contest often comes from a totally unexpected source.

B. Special Planning to Protect the Beta Spouse (The Anatomy of a Will Contest).

1. THE PROBLEM: Both the Alpha Spouse and the Beta Spouse usually desire to protect the estate plan that provides for the Beta Spouse. If the Alpha Spouse dies first then the Beta Spouse faces a potential attack on the estate plan with a competitive disadvantage with respect to the contestants.

a. 177(b) Considerations if the Alpha Spouse Dies First[1]. The personal representative of the Alpha Spouse=s estate will administer not only the Alpha Spouse=s separate property, but also the community property which was by law under the management of the Alpha Spouse during his or her lifetime, and all of the community property that was by law under the joint control of both spouses during the continuance of the marriage. Tex. Prob. Code Ann. ' 177 (b).

b. The Effect of a Will Contest on the Administration of the Alpha Spouse=s Estate. If a will contest is filed, the court will usually appoint a temporary administrator to administer the Alpha Spouse=s estate pending the resolution of the will contest. Tex. Prob. Code Ann. ' 132. Even if the Beta Spouse is named as the personal

[1] This is frequently the case because, in many situations, the Alpha Spouse is a male and is older than the Beta Spouse.

representative of the Alpha Spouse=s estate in his or her will, the Beta Spouse will probably not be appointed as his or her temporary administrator pending the will contest. Many courts routinely appoint an independent party to serve in that capacity until the will contest is resolved.

c. Cost of Temporary Administration. Temporary administrations are cumbersome and expensive. The cost of administering the Alpha Spouse=s estate through a temporary administration will be substantially greater than the process contemplated in his or her will.

d. Access To Funds. Tex. Prob. Code Ann. '177 (b) creates a problem for the Beta Spouse in the event of a will contest. This is especially true if all of the community estate was under the sole management of the Alpha Spouse at the time of his or her death. In this situation, all of the marital assets become subject to the management and control of the temporary administrator. The Beta Spouse is left with no property under his or her management and control. The Beta Spouse is often forced to deal with an unknown party (and a court) to obtain the resources necessary to provide for his or her health, support and maintenance.

In this situation the Beta Spouse is also denied access to the funds necessary to defend the Alpha Spouse=s estate plan.

e. Characterization of Marital Property. My experience indicates these problems are compounded when the will contest is coupled with a contest of the separate/community characterization of the marital property.

If the Alpha Spouse=s descendants contest his or her will, they may contend that he or she died intestate. If they prevail in this contention, they would collectively receive the Alpha Spouse=s one-half of the community estate (Tex. Prob. Code Ann. ' 45), two-thirds of the Alpha Spouse=s separate personal property (Tex. Prob. Code Ann. ' 38), and all of the Alpha Spouse=s separate real property (subject to the Beta Spouse=s life estate in one-third of such real property, Tex. Prob. Code Ann. ' 38).

The Beta Spouse will, of course, retain his or her one-half community interest in the marital estate. This property may not, however, be sufficient to provide for the Beta Spouse=s health, support and maintenance or to provide the Beta Spouse with sufficient assets to fund her defense of the estate plan.

There is, therefore, an incentive for the contestants to contend that all of the Alpha Spouse=s estate consists of separate property (rather than an undivided interest in community property).

Suits involving separate/community property categorization are particularly difficult and expensive. These suits involve massive document production and the use of accounting and legal experts. My experience teaches that separate property is easier to trace than most lay persons think. The process, however, is complex.

f. Confidentiality. It is impossible to maintain confidentiality through a traditional probate proceeding. This problem is compounded when there is a will contest. Even if the Alpha Spouse=s will is not contested, the Beta Spouse (or someone else acting as independent executor of his or her estate) will be required to file an inventory with the probate court listing most of the assets the Alpha Spouse owned at the time of his death. Tex. Prob. Code Ann. ' 250.

g. Expense of the Will Contest. Even if the Beta Spouse wins the will contest, the cost of defending it will be substantial.

If the Alpha Spouse=s estate is large enough, a plaintiff=s attorney might be enticed to take a will contest on a contingent fee basis. If the Beta Spouse=s only interest in the Alpha Spouse=s estate is a life estate in a spendthrift trust then the Beta Spouse may have trouble hiring an attorney to take her case on a contingency basis (even if she does, a contingency is an expensive price to pay to defend the Alpha Spouse=s estate plan). The Beta Spouse may, therefore, have to pay hard dollars to defend the will contest while the contestants will have no material out-of-pocket expense.

The Beta Spouse, if appointed independent executor of the Alpha Spouse=s estate, may be entitled to receive reimbursement of his or her legal fees from the Alpha Spouse=s estate for defending his will if a jury finds that he or she prosecuted the proceeding in Agood faith.@ Tex. Prob. Code Ann. ' 242. However, any reimbursement would be paid, in part, out of funds the Beta Spouse would otherwise have inherited from the Alpha Spouse, but for the will contest.

The Beta Spouse might be able to countersue the contestants (and possibly their attorneys) for tortious interference with inheritance rights. This litigation would, again, be very expensive and difficult to win.

h. Will Contest Litigation is Emotional. Fiduciary litigation is intensely emotional. These cases tend to destroy family relationships and are very trying for the persons involved.

2. A PROPOSED SOLUTION. Our firm sometimes recommends the creation of a revocable management trust to protect the Beta Spouse.

Many estate planners are currently touting the benefits of revocable management trusts. They claim these trusts reduce the costs of probate and, in some instances, save estate taxes. I want to stress that our firm does not belong to this group of estate planners. We do not routinely recommend revocable management trusts and do not believe that they materially reduce the cost of probate or save taxes. In fact, there are costs associated with creating and maintaining these trusts that would not be necessary if they were not created.

Under this plan both spouses transfer most of their assets to a trust. The trust provides that the income and, if necessary, the principal would be available for the use

of both spouses during their lifetimes. The trust can be revoked or modified at any time. The trust is drafted in such a way as to be as tax neutral as possible (i.e. the trust would have virtually no income or gift tax consequences to either of the spouses during their lifetimes -- they would continue to report income and pay taxes as if the trust did not exist). The trust would dispose of each spouse=s estate upon his or her death and would contain all of the estate planning provisions normally contained in a will.

The trust usually provides that both spouses are trustees of this trust. The trust provides that if one spouse fails or refuses to serve or to continue to serve as trustee, the other spouse automatically becomes the sole trustee of the trust. The trust is usually structured to allow the Alpha Spouse to continue to manage the marital estate during his or her lifetime.

The reasons for a revocable management trust to protect the Beta Spouse are as follows:

a. Management. If a will contest is filed, a management trust will eliminate most of the problems incident to management and control of the community estate described above.

The trust estate of the management trust will not be included in the Aprobate estate@ of the Alpha Spouse (under this scenario, the first spouse to die) and, as a result, will not be subject to temporary administration. Management and control of the assets comprising the trust estate of the management trust will remain in the successor trustee of the management trust.

b. Support to the Beta Spouse During the Contest. The principal and income of the trust will be available for the support and maintenance of the Beta Spouse during the contest without any direct intervention of the probate court. Simply stated, the trust will continue to operate after the death of the first spouse to die without the intervention of the probate court.

It is possible, however, that a contestant will bring an action to attack the management trust. This contingency is dealt with below.

c. Confidentiality. Absent litigation, and assuming that the trust is fully funded by inter vivos transfers, both spouse=s financial affairs will remain confidential. Because the trust estate of the trust is not a part of the probate estate of either spouse, it will not be necessary for the personal representative of either spouse to file any public document in the probate court disclosing the nature or value of the assets in the management trust.

d. Funds Available To Fight The Contest. The Beta Spouse will have all of the resources of the trust estate at his or her disposal to fight a will contest or an attack on the trust. The trust should be written to allow the trust principal to be used to defend entirely a contest of the trust or of the Alpha Spouse=s will. The surviving

spouse, as trustee, has the legal right and fiduciary duty to use the resources of the trust to defend any attack on the trust.

e. Competency Standard. The mental capacity necessary to execute a valid trust is less than the mental capacity necessary to execute a valid will (testamentary capacity). It is therefore more difficult for a person to contest a trust than a will.

f. Characterization of Marital Property. The trust may reduce the incentive to attack the separate/community characterization of the marital property. The trust provides that certain property passes to the surviving spouse upon the death of the first spouse to die regardless of whether or not the property was community. This might reduce or eliminate a contestant=s incentive to mount a characterization attack on the marital property.

As indicated in paragraph B(5) above, there is an incentive for a contestant to contend that all of the Alpha Spouse=s estate consists of separate property (rather than an undivided interest in community property). A management trust would reduce this incentive because it would provide that the Beta Spouse would receive specific property regardless of whether it is separate or community property. In order to get a portion of the Alpha Spouse=s estate by intestacy, the contestants will have to set aside both the trust and the Alpha Spouse=s will.

g. Distributions To Potential Contestants During the Life of the Alpha Spouse. The trust may provide for discretionary payments of income to the anticipated contestants (usually the Alpha Spouse=s descendant=s) prior to the death of the Alpha Spouse. After the Alpha Spouse=s death these payments would cease.

The trustee(s) can then make small periodic payments of income to the anticipated contestants and their descendants during the Alpha Spouse=s lifetime. Receipt of these payments may prevent these persons from successfully contesting the trust.

A general premise of trust law is that a beneficiary may not receive a benefit from a trust and subsequently contest its validity. While there are numerous Texas cases holding that a person may not receive benefits under a will and subsequently contest it [see *In The Matter of the Estate of William G. McDaniel, Deceased,* ___ S.W.2d ___ (Tex. App. Texarkana 1996)], there are few cases applying this principle to trusts. I believe, however, that the concept of making small periodic income distributions from the trust to the anticipated contestants will strengthen the Beta Spouse=s defense of the trust if its validity is attacked.

There is no Texas case clearly on point. There is out-of-state authority for the proposition that, once a beneficiary accepts benefits from a trust, he cannot later attack the validity of the trust. In *Canning v. Bennett,* 245 P. 2d 1149, 1157, 206 Okl. 675, 683 (1952), the Oklahoma Supreme Court held that, where a person sold a portion of her beneficial interest in a trust and had accepted thousands of dollars of benefits under the trust, she had over a period of years ratified the trust by long acquiescence and by acceptance of benefits thereunder, and she could not later be

heard to question the validity of the trust, nor could her heirs be heard to question the validity of the trust after her death. *See also* Bogert, Trusts and Trustees, 2nd Ed. ' 170.

A Texas court has held that one cannot accept benefits under a testamentary trust and then contest the validity of the will creating the trust. *Traylor v. Orange,* 675 S. W. 2d 802, 805 (Tex. App. -- Beaumont 1984, no writ). The *Traylor* court cites *Trevino v. Turcotte*, 564 S. W. 2d 682, 685-6 (Tex. 1978), in which the Texas Supreme Court writes:

> It is a fundamental rule of law that a person cannot take any beneficial interest under a will and at the same time retain or claim any interest, even if well founded, which would defeat or in any way prevent the full effect and operation of every part of the will.

Thus, the rule stated in *Traylor* may have nothing to do with acceptance of benefits as a matter of trust law and instead relate only to acceptance of benefits under a will.

In *Baylor University v. Ogilvie,* 222 S. W. 2d 164, 167 (Tex. Civ. App. -- San Antonio 1949, no writ), Mr. and Mrs. Ogilvie made a joint will and, at the same time Mr. Ogilvie created an inter vivos trust benefitting Mrs. Ogilvie. Mr. Ogilvie died and his will was admitted to probate. Mrs. Ogilvie allegedly received benefits under the will and inter vivos trust. Then Mrs. Ogilvie made known her intention of contesting the will (but, apparently, not the inter vivos trust). Baylor University, who stood to suffer if the will was not probated, asserted that Mrs. Ogilvie had accepted benefits under the will *and trust agreement* and could not now refuse to recognize and accept under the will. The court appeared to accept Baylor=s argument, although this was not the decisive issue in the case. It is not clear if the acceptance of *trust benefits* had anything to do with the beneficiary=s ability to later challenge the *trust*.

However, a recent Texas case holds that there can be no ratification or waiver from the acceptance of benefits by a person who did not have knowledge of all material facts. *Byrd v. Woodruff,* 891 S. W. 2d 689, 699 (Tex. App. -- Dallas 1994, writ denied). *Byrd* cites *Frazier v. Wynn*, 472 S. W. 2d 750, 753 (Tex. 1971), for this proposition. In *Frazier*, the benefits accepted arose under a lease, not a trust, but *Byrd* may make the rule regarding knowledge of material facts applicable in the trust context as well.

The knowledge of material facts requirement apparently does not apply with respect to accepting benefits under a will. In *Sheffield v. Scott,* 620 S. W. 2d 691, 694 (Tex. App. -- Houston [14th Dist.] 1981, no writ), the court of appeals held:

> Whether appellants had knowledge of all the facts and of all their rights at the moment they accepted the benefits is immaterial to a determination that they, by their acts and conduct after acceptance, became estopped to contest the will.

The general rule is that notice by the settlor to the beneficiary of the creation of a trust is not necessary to the completion of the trust, subject to the power of the beneficiary to reject the trust when he is informed of it. Bogert, *Trusts and Trustees*, 2nd Ed. ' 169. Thus, if the beneficiary does not accept the trust, no trust is created. *See Neblett v. Valentino*, 127 Tex. 279, 286, 92 S. W. 2d 432, 435 (1936) (holding that the plaintiff could refuse to accept the benefits of an alleged trust and instead hold the putative trustee responsible for the funds with which he was entrusted rather than asserting title to the property constituting the res of the alleged trust).

In Texas, acceptance by a beneficiary of an interest in a trust is presumed. Tex. Prop. Code ' 112.010(a). Nevertheless, most states in general and Texas in particular recognize the ability of a beneficiary to disclaim an interest in a trust. *See* Tex. Prop. Code ' 112.010. In Texas, one wishing to disclaim an interest in a nontestamentary trust may do so only if the person in his capacity as beneficiary has neither "exercised dominion and control over the interest@ nor Aaccepted any benefits from the trust." Tex. Prop. Code ' 112.010(c-1).

Thus, if a person accepts benefits from a trust -- apparently even minor benefits -- he may not later disclaim his interest in the trust. *See also Aberg v. First Natl. Bank,* 450 S. W. 2d 403, 407 (Tex. Civ. App. -- Dallas 1970, writ ref=d. n. r. e.).

Of course, disclaimers usually arise when one person wishes for property (in this case, trust benefits) to pass to another person for tax or creditor purposes. Texas=s trust disclaimer statute merely tracks what is permitted by federal tax law with respect to disclaimers. Nevertheless, the existence of the disclaimer statute could help in raising an estoppel argument if a trust beneficiary attacks the validity of a trust even after accepting minor benefits therefrom.

h. Limited Power of Appointment. If the Alpha Spouse is willing to do so, the Beta Spouse should be given (in her individual capacity and not as trustee) a limited power of appointment over the corpus of the trust that would otherwise go to the Alpha Spouse=s descendants upon the Beta Spouse=s death. This should be both an inter vivos and a testamentary power. Giving the Beta Spouse the power to appoint the remainder of the trust among a class comprised of the Alpha Spouse=s descendants (and perhaps a charity) will create a disincentive for a single contestant to bring a contest.

Another benefit of the limited power of appointment is to insulate the Beta Spouse from breach of fiduciary duty litigation regarding the administration of the trust. If a beneficiary threatens litigation then the Beta Spouse may be able to exercise the power and remove the potential plaintiff as a "interested person" as such term is used in Texas Trust Code '115.011(a). The threat of disinheritance should also have a psychological impact on the potential plaintiff.

i. Statute of Limitations. The anticipated contestants should be given copies of the management trust shortly after it is created. This should start the statutes of limitation or laches running against their contest of the trust. More importantly, it may

force them to institute their contest against the Alpha Spouse while he or she is living (rather than against the Beta Spouse after the Alpha Spouse is deceased).

j. The Will. Both spouses should draft wills that leave each of their estates to the trust. Simply stated, the trust would control the disposition of both spouses = estates and would contain all provisions dealing with estate planning.

C. Planning for the Alpha Spouse. In most situations the Alpha Spouse will be as interested in insuring the implementation of his or her estate plan as the Beta Spouse. He or she will usually favor the implementation of the plan outlined above for the Beta Spouse.

There are, however, special considerations that uniquely relate to the Alpha Spouse.

The Alpha Spouse will be especially concerned about the classification of marital property (the Alpha Spouse will anticipate that the Beta Spouse = s distributees or, in the event of divorce, the Beta Spouse, will contend that a substantial portion of the trust estate of the trust is community property rather than the Alpha Spouse = s separate property. See *Lemke v. Lemke,* __ S.W.2d __ (Tex. App.-Forth Worth, 1996) The trust should be carefully drafted to preserve the separate property classification of the Alpha Spouse = s property.

The Alpha Spouse will also be concerned about the contingency of the Beta Spouse predeceasing him or her. If the trust provides for the Alpha Spouse = s use of the income and/or corpus of the Beta Spouse = s property during the Alpha Spouse = s lifetime then the Alpha Spouse should have a limited power of appointment over the property going to the Beta Spouse = s distributees on the death of the Alpha Spouse. If the trust is to terminate on the date of the Beta Spouse = s death, special provision should be made to keep the Beta Spouse = s property in trust after the Beta Spouse = s death until the statute of limitations on a contest of the trust has run.

D. Planning with Respect to Other Potential Contest Situations. Other potential contest situations involve unique planning opportunities that are specifically designed to address specific factual situations. Our firm uses various types of trusts for the reasons set forth in paragraph B. above, occasionally uses in terrorem clauses, and sometimes uses extraordinary measures in the execution of the will.

In a potential contest situation the execution of the documents (especially the will) should be carefully considered. Thought should be given to how the contestant will react to extraordinary execution procedures (i.e. if the person is competent, then why utilize these procedures?). Some of the options available are:

1. A VIDEOTAPE OF THE EXECUTION: The execution of an estate planning document probably should not be videotaped unless the person signing the document is comfortable in front of a camera, is unquestionably competent, fully understands his or her estate plan and can clearly establish that he or she has testamentary capacity. I

have never videotaped the execution of an estate planning document because of the risk inherent in this type of procedure. This procedure leaves little if anything to the jury = s imagination. Even the slightest mistake can prove to be a major problem during the trial of the contest.

2. MORE THAN TWO WITNESSES: Multiple witnesses are used to insure that at least one of the witnesses will survive the person executing the document and will be available at trial.

Many law firms use three witnesses because there are some jurisdictions that require three witnesses to a will and they never know if the person executing the will will acquire property in one of these jurisdictions after the will is signed. (They hopefully will know whether such person owns property in such jurisdictions at the time the will is executed.)

3. SPECIAL WITNESSES: I frequently use special witnesses in potential contest situations. The ideal witness is someone who is completely disinterested in the outcome of the proceeding (including the attorney who drafted the documents and his or her staff), who has credentials for truth and veracity, who is likely to survive the person signing the document and who will make a good witness at trial.

In a contest situation, the attorney drafting the documents should probably not be a witness (he or she will be a witness anyway and juries usually hate attorneys). The attorney should probably not grab the nearest two (or more) secretaries and ask them to be witnesses (they may not work for the law firm at the time of the contest and may, at that time, harbor resentment against the law firm and/or the client).

Some attorneys use psychiatrists or psychologists as witnesses. I do not generally favor this approach because of the appearance that competency was a close call and necessitated extraordinary measures.

In my opinion, the best witnesses are close family friends who have known the person very well for a long period of time. Other innovative witnesses are members of the clergy or business associates.

E. In terrorem Clauses.

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 Fiduciary; or shall institute any cause of action (including, but not limited to, any cause of action for tortious interference with inheritance rights) against any person which is based in any way on the proposition that I was not of sound mind, lacked testamentary capacity, was unduly influenced, or failed to comply with any applicable law at the time that I executed any legal instrument** (any of the acts described above are hereinafter referred to as "Prohibited Acts"); then, in any such contingency, all benefits provided for such Distributee are revoked and such benefits shall pass to the Residuary Distributees under this Will (other than such Distributee and/or to the descendants of 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 _____, a charitable institution. **If any distribution has been made to any Distributee prior to the time he engages in a Prohibited Acts, then the Distributee shall repay to my Fiduciary or, if applicable, to my trustee, the amount of any such distribution plus simple interest at a rate of six per cent per annum and all attorney fees and expenses incurred in collecting this distribution and any adult Distributee must agree in writing to this provision of this Will prior to receiving or continuing to receive any distribution. To the greatest extent permitted by Texas law this provision of this Will shall apply to any Distributee regardless of whether or not any Prohibited Acts was taken in good faith and with probable cause. If my Fiduciary elects to take a marital deduction or charitable deduction on my Federal Estate Tax return then no provision of this In Terrorem clause shall apply to my surviving spouse or, if applicable, to any charity.** This provision shall survive the administration of my estate and shall expressly apply to the administration of any trust created in this Will. No distributee shall be deemed to have violated this clause solely because he or she disclaims any interest in my estate and any trust created under this Will."

2. VALIDITY OF THE CLAUSE: In terrorem clauses are valid in Texas. See ***Hammer v. Powers,*** 819 S.W.2d 669 (Tex.Civ.App.--Ft. Worth 1991, no writ); ***Calvary v.***

Calvary, 122 Tex. 204, 55 S.W.2d 527 (Tex. Comm. App.1932, opinion adopted); ***Massie v. Massie***, 118 S.W. 219 (Tex.Civ.App. 1909).

In terrorem clauses will, however, be strictly construed. 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.); ***Sheffeild v. Scott,*** 662 S.W.2d 674 [Tex.Civ.App.--Houston (14th Dist.) 1983, writ ref=d. n.r.e.)

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

3. USE OF THE CLAUSE: In terrorem clauses should never be boilerplate provisions in a will or trust. The same considerations apply to in terrorem clauses as are discussed with respect to exculpatory clauses below. 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.

III. FIDUCIARY PROTECTION CLAUSES

A. Exculpatory Clauses.

1. THE CLAUSE: Notwithstanding anything to the contrary herein, my Fiduciary shall, to the greatest extent permitted by Texas law at the time this clause is construed, be exculpated from any liability whatsoever for any alleged abuse of discretion, tort, breach of fiduciary duty and/or breach of trust caused by any act or omission in the administration of my estate or any trust created under my Will. As a consequence, no person, firm or corporation ever serving as my Fiduciary shall ever be held personally liable to any other person, firm or corporation for any damages directly or indirectly arising out of any act or omission committed in the administration of my estate or in

the administration of any trust created under my Will. This exculpation shall not, however, protect my Fiduciary from any liability for self dealing, bad faith, acts which are intentionally adverse to a Distributee or acts of reckless indifference toward the interest of a Distributee. Even if this exculpation clause shall not protect my Fiduciary because of the foregoing sentence, in no event shall my Fiduciary ever be liable for any punitive or exemplary damages for any act or omission committed in the administration of my estate or in the administration of any trust created under my Will regardless of whether such act or omission constituted gross negligence, self dealing, bad faith, reckless indifference to my Distributees or intentional harm to my Distributees. This provision shall survive the administration of my estate and shall expressly apply to the administration of any trust created in this Will."

2. VALIDITY OF THE CLAUSE: Exculpatory clauses are valid in Texas. ***Corpus Christi National Bank v. Gerdes,*** 551 S.W.2d 521 (Tex.Civ.App.--Corpus Christi 1977, writ ref=d. n.r.e.); ***Neuhaus v. Richards,*** supra; ***Interfirst Bank of Dallas, N.A. v. Risser,*** 739 S.W.2d 882 (Tex.Civ.App.--Texarkana 1987, no writ). Exculpatory clauses will, however, be strictly construed against exculpation. ***Jewett v. Capital National Bank of Austin,*** 618 S.W.2d 109 (Tex.Civ.App.--Waco 1981, writ ref=d. n.r.e.). However, there are statutory limitations on the use of exculpatory clauses.

Texas Trust Code 113.059 provides in part that:

(c) A Settlor may not relieve the trustee of liability for:

(1) a breach of trust committed:

(A) in bad faith;

(B) intentionally; or

(C) with reckless indifference to the interest of the beneficiary; or

(2) any profit derived by the trustee from a breach of trust.

(d) A provisi0n in a trust instrument relieving the trustee of liability for a breach of trust in ineffective to the extent that the provision is inserted in the trust instrument as as result of an abuse by the trustee of a fiduciary duty to or confidential relationship with the settlor.

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

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

As a general proposition, if a fiduciary has a close personal relationship with the settlor of the instrument, and if the fiduciary is not receiving compensation for his services as a fiduciary, then some form of exculpation from fiduciary liability may be warranted. For example, if a settlor appoints his wife as trustee of a trust for his children, to serve without compensation, then the settlor may want to limit the trustee's potential liability.

On the other hand, a law firm that includes an exculpatory clause as boilerplate in its estate planning documents is courting disaster. This is especially true when the fiduciary is an entity with whom the law firm has a pre-existing relationship (such as a bank that the law firm represents on a regular basis). Also, if the fiduciary is a corporation charging a full fee for its services as a fiduciary, then exculpation of the fiduciary from liability is hard to justify. In fact, the traditional reason for appointing a corporate fiduciary was the financial resources of a corporate fiduciary to make good any loss they caused the estate or trust (before they went broke in the 1980's).

B. Legal Expense Clauses.

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

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

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

C. 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 beneficiary automatically agrees that any other party can force mediation or arbitration of disputes.

While it is not clear whether "binding" arbitration in these cases would be upheld, my experience indicates that even 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 publication entitled *Arbitration Rules For Wills and Trusts* (effective October 1, 1995). 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.

The American Arbitration Association recommends the following provision:

> In order to save the cost of court proceedings and promote the prompt and final resolution of any dispute regarding the interpretation of my will (or my trust) or the administration of my estate or any trust under my will (or my trust), I direct that any such dispute shall be settled by arbitration administered by the American Arbitration Association under its Arbitration Rules for Wills and Trusts then in effect. Nevertheless the following matters shall not be arbitrable - questions regarding my competency, attempts to remove a fiduciary, or questions concerning the amount of bond of a fiduciary. In addition, arbitration may be waived by all *sui juris* parties in interest.
>
> The arbitrator(s) shall be a practicing lawyer licensed to practice law in the state whose laws govern my will (or my trust) and whose practice has been devoted primarily to wills and trusts for at least ten years. The arbitrator(s) shall apply the substantive law (and the law of remedies, if applicable) of the state whose laws govern my will (or my trust). The arbitrator=s decision shall not be appealable to any court, but shall be binding on any and all persons who have or may have an interest in my estate or any trust under my will (or my trust), including unborn or incapacitated persons, such as minors or

incompetents. Judgment on the arbitrator=s award may be entered in any court having jurisdiction thereof.

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.

IV. CONCEPT CLAUSES *(WE AREN'T IN KANSAS ANYMORE)*

A. 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 strongly recommend that they not be included in your boilerplate fiduciary powers.

B. Imposed Limitation of Actions.

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."

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

C. Virtual Representation.

1. THE CLAUSE: Only living persons shall be necessary parties in any cause of action incident to or appertaining to my estate or any trust created under this Will. It is also my desire that no attorney ad litem be appointed to represent any unknown heirs,

unnamed contingent beneficiaries designated as a class or unascertained distributees under this Will (or any trust created under this Will), and to this end I declare that I would prefer for such distributees to take nothing from my estate (or any trust created under this Will) rather than for my estate or trust to bear the cost of ad litem fees in any legal proceeding affecting them. I further direct that any judgment, order, or decree entered in any court of competent jurisdiction in any cause of action appertaining to or incident to my estate (or any trust created under my Will) shall be as fully binding against any unknown heirs, contingent beneficiaries designated as a class or unascertained beneficiaries as if such persons were living and a party to the proceeding at the time the judgment, order, or decree was entered."

2. USE OF THE CLAUSE: This is a clause which, if valid, should probably be used in most wills and trusts. The fees of attorneys ad litem in fiduciary litigation is staggering. The appointment of ad litems often inhibits settlement of fiduciary litigation cases due to the fact that the ad litems, 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.

D. Recognition of Virtual Representation.

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

E. Imposition of Legal Fees on Unsuccessful Litigants.

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

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

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

F. Elimination of Derivative Causes of Action.

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."

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.

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

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."

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.