

# THE 21<sup>ST</sup> CENTURY TRUST: AN EVOLVING CONCEPT

The trust . . . is a device for making dispositions of property. And no other system of law has for this purpose so flexible a tool. It is this that makes the trust unique. . . . The purposes for which trusts can be created are as unlimited as the imagination of lawyers.

A. Scott, Trusts, 3, 4 (3d Ed. 1967)

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# **THE 21<sup>ST</sup> CENTURY TRUST** **IT'S NOT YOUR FATHER'S TRUST**

*The Express Trust . . . the greatest and most distinctive achievement performed by Englishmen in the field of jurisprudence.* Frederic Maitland, legal scholar.<sup>1</sup>

## **I. Definitions**

Generally, an express trust can be described as a form of concurrent ownership of property whereby one or more trustees manage property for one or more beneficiaries. The trustees, as fiduciaries, hold legal title to the property. The beneficiaries own equitable title and may be entitled to distributions from the trust income and trust principal.

But what is an express trust? Is it a device, an entity, a contract or something else? What are the corresponding duties and rights of the trustees and beneficiaries? Are they defined by the common law, statute or contract? The answer to these questions may be an “all of the above.”

Although the express trust is a common law concept, the Texas legislature codified much of Texas’ law of trusts into the Texas Trust Act in 1941 (effective April 19, 1943, Article 7425b 1-47, Vernon’s Texas Civil Statutes). Effective January 1, 1984, a major substantive revision to the Act was incorporated as the Texas Trust Code into the Texas Property Code. In this paper, reference is also made to the *Restatement of the Law, Trusts*, both the 1935, 1957 and latest versions, when a more general national perspective is relevant.

### **A. Restatement (First and Second) of Trusts § 2**

“A trust, as the term is used in the Restatement of this Subject, when not qualified by the word “charitable,” “resulting” or “constructive,” is a fiduciary relationship with respect to property, subjecting the person by whom the property is held to equitable duties to deal with the property for the benefit of another person, which arises as a result of a manifestation of an intention to create it.”

### **B. Texas Trust Act**

“Trust” for the purpose of this Act means an express trust only, and does not include (1) resulting or constructive trusts, (2) so-called “Massachusetts Trusts” or similar business trusts, (3) security instruments such as deeds of trust, mortgages and conditional sales contracts, (4) instruments wherein one or more persons are mere nominees for one or more persons without any disclosed beneficiaries and without any

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<sup>1</sup> Frederic W. Maitland, *The Unincorporate Body* in 3 Frederic W. Maitland, *Collected Papers* 271, 272 (1911)

active trust duties. Texas Trust Act § Two. (Note, the Act did not define the term “express trust.”)

C. Texas Trust Code

“Express trust” means a fiduciary relationship with respect to property which arises as a manifestation by the settlor of an intention to create the relationship and which subjects the person holding title to the property to equitable duties to deal with the property for the benefit of another person.

D. Restatement (Third) of Trusts § 2

“A trust, as the term is used in this Restatement when not qualified by the word “resulting” or “constructive,” is a fiduciary relationship with respect to property, arising from a manifestation of intention to create that relationship and subjecting the person who holds title to the property to duties to deal with it for the benefit of charity or for one or more persons, at least one of whom is not the sole trustee.”

E. Trust as an Entity

“Increasingly, modern common law and statutory concepts and terminology tacitly recognize the trust as a legal “entity,” consisting of the trust estate and the associated fiduciary relation between the trustee and the beneficiaries. This is increasingly and appropriately reflected both in language (referring, for example, to the duties or liability of a trustee to “the trust”) and in doctrine, especially in distinguishing between the trustee personally or as an individual and the trustee in a fiduciary or representative capacity.” Restatement (Third) of Trusts, Comment § 2(a)

Treating a trust as if it were an “entity” is finding its way into Texas law (e.g., see Texas Trust Code § 117.011(c), which states, “. . . when a trustee is not liable to the beneficiaries or the trust”). Even the Texas Supreme Court has described the trust as an entity. See IIB, *infra*.

F. UTC/UPC

Interestingly, the Uniform Trust Code does not define the word “trust” or “express trust.” Neither does the Uniform Probate Code.

## II. **Duty of Loyalty**

At common law a trustee assumed the fundamental fiduciary duties of carrying out the purposes of the trust, employing due care, exercising impartiality and providing accountings, among others, all of which were incorporated as default rules into both the Texas Trust Act and the Texas Trust Code. Justice Benjamin Cardozo, a renowned common law scholar, explained perhaps the most sacred duty of a trustee, the duty of loyalty, as follows:

Many forms of conduct permissible in a workaday world for those acting at arm's length are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the marketplace. Not honesty alone, but the punctilious of an honor the most sensitive, is then the standard behavior. As to this, there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the "disintegrating erosion" of particular exception. [Citations omitted.] Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd. It will not consciously be lowered by any judgment of this court. *Meinhard v Salmon*, 249 N.Y. 458, 464, 165 N.E. 545, 546 (1928)

Common law courts frequently invoked the "no further inquiry rule" when a trustee engaged in self-dealing. In such situations, the self-dealing was a per se violation of the duty of loyalty and the transaction was voidable by the beneficiaries, even if the trustee acted in good faith and the transaction was fair to the beneficiaries. Is the "no further inquiry rule" still good law? Or is "good faith" and "fair dealing" an affirmative defense to an act of self-dealing? The modern trend suggests there are increasingly court-created exceptions that may eventually override the rule. See William P. LaPiana, *Inside Wills and Trusts*, pp. 346-347 (Wolters Kluwer, 2012)

### **III. Settlor Intent**

In *Fleck v. Baldwin*, 172 S.W.2d 975 (Tex. 1943), the Texas Supreme Court focused on the intent necessary to create a valid express trust, explaining that it must be evident from the terms of the intended trust that it was the settlor's intent that subsequent wrongdoing by the trustee would be wrongful and a breach of duty owing by the "trustee" to the "beneficiary" with resulting liability. This explanation reflected the then existing common understanding that a trust was a fiduciary relationship subjecting the person who had legal title to legally enforceable duties to deal with the property for the benefit of the beneficiary. See *Black's Law Dictionary*, "trust" (Revised 4<sup>th</sup> Ed., 1968).

Decades later, in a landmark Texas case, *Westerfeld v. Huckaby*, 474 S.W.2d 189 (Tex. 1971), the Texas Supreme Court effectively recognized that the validity of an express trust was not affected by the settlor/trustee's retained power to revoke the trust so long as a beneficial interest had been created in someone other than the settlor. This decision, in the author's opinion, reflects a "sea change." The Texas Supreme Court had followed the developing trend of modern authorities upholding the validity of inter vivos trusts, regardless of how extensive the powers reserved by the settlor, thereby effectively eliminating any real risk of personal liability of the settlor/trustee. Restatement (Second) Trusts § 57 (1959), G. Bogert, *Trust & Trustees*, § 104 (2<sup>nd</sup> Ed., 1965) and A. Scott, *The Law of Trusts*, § 57.2 (3<sup>rd</sup> Ed., 1917). The "trend" was later codified in the Texas Trust Code.

A. Texas Trust Code

If during the life of the settlor an interest in a trust or the trust property is created in a beneficiary other than the settlor, the disposition is not invalid as an attempted testamentary disposition merely because the settlor reserves or retains, either in himself or another person who is not the trustee, any or all of the other interests in or powers over the trust or trust property, such as: . . .

- (2) The power to revoke, modify or terminate the trust in whole or in part; . . .
- (4) The power to control the administration of the trust in whole or in part. . . .

See Texas Trust Code § 112.033.

B. Separation of Legal and Equitable Estates

The Texas Supreme Court again addressed the intent necessary to create a valid express trust in light of the then new Texas Trust Code. “Implicit in this statutory definition is the requirement of a trustee with administrative powers and fiduciary duties. . . . Even more fundamental than this, it is well established that the legal and equitable estates must be separated; the former being vested in the trustee and the latter in the beneficiary. . . . This separation of the legal and equitable estates in the trust property is the basic hallmark of the trust entity. Technical words of expression, however, are not essential for the creation of a trust. To create a trust by a written instrument, the beneficiary, the res and the trust purpose must be identified.” *Perfect Union Lodge v. Interfirst Bank*, 748 S.W.2d 218 (Tex. 1988).

C. Expanded Powers/Limited Duties

*Westerfeld* and *Perfect Union Lodge* followed the modern trend that appears to enable a settlor to grant to non-settlor trustees extensive powers and to relieve them of what a common law court would have considered to be fundamental fiduciary duties without affecting the trust’s validity. Section Twenty-Two of the Texas Trust Act had provided that the trustor could relieve a trustee from any or all of the duties, restrictions and liabilities which would otherwise be imposed. However, the trustor could not relieve a corporate trustee from certain duties relating to loan of trust funds to “self,” depositing funds with “self,” buying from or selling to “self.” This concept was incorporated into Section 113.059 of the Texas Trust Code, which was then repealed in 2005.

D. Section 113.059 (Repealed)

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

(b) A settlor may not relieve a corporate trustee from the duties, restrictions or liabilities of Section 113.052 or 113.053 of this Act (relating to self-dealing by corporate fiduciaries).

See Texas Trust Code § 113.059 (as enacted). This section was repealed, effective Jan. 1, 2006 and replaced by Section 111.0035.

E. Section 111.0035(b)

- (a) Except as provided by the terms of a trust and Subsection (b), this subtitle governs:
  - (1) the duties and powers of a trustee;
  - (2) relations among trustees; and
  - (3) the rights and interests of a beneficiary.
- (b) The terms of a trust prevail over any provision of this subtitle, except that the terms of a trust may not limit:
  - (1) The requirements imposed under Section 112.031 (relating to improper trust purposes);
  - (2) The applicability of Section 114.007 to an exculpation term of a trust;
  - (3) The periods of limitation for commencing a judicial proceeding regarding a trust;
  - (4) A trustee's duty:
    - (A) With regard to an irrevocable trust, to respond to a demand for accounting made under Section 113.151 if the demand is from a beneficiary who, at the time of the demand:
      - (i) Is entitled or permitted to receive distributions from the trust; or
      - (ii) Would receive a distribution from the trust if the trust terminated at the time of the demand; and
    - (B) To act in good faith and in accordance with the purposes of the trust; and
  - (5) The power of a court, in the interest of justice, to take action or exercise jurisdiction, including the power to:
    - (A) Modify or terminate a trust or take other action under Section 112.054;
    - (B) Remove a trustee under Section 113.082;
    - (C) Exercise jurisdiction under Section 115.001;
    - (D) Require, dispense with, modify or terminate a trustee's bond;
    - (E) Adjust or deny a trustee's compensation if the trustee commits a breach of trust; or
    - (F) The applicability of Section 112.038 (relating to forfeiture clauses).
- (c) The terms of a trust may not limit any common law duty to keep a beneficiary of an irrevocable trust who is 25 years of age or older informed at any time during which the beneficiary:
  - (1) Is entitled or permitted to receive distributions from the trust; or
  - (2) Would receive a distribution from the trust if the trust were terminated.

See Texas Trust Code § 111.0035 (added 2005, amended in 2007, 2009). A 2017 legislative proposal would amend Section 111.0035(b)(5) to expressly authorize the court to not only modify an existing trust, but also reform it pursuant to Section 112.054. See SB 617, HB 1354 (2017).



## F. Trusts as Contracts

“Historically, trusts were considered a creation of property law and the rights of the beneficiaries and the corresponding duties of trustees were defined by property law concepts. ‘While the law traditionally has not treated trusts as contracts, leading legal scholars have long acknowledged that there is a contractual aspect to trusts. The Restatement 3d of Trusts points out, however, that [t]his ‘contractual approach’ . . . was certainly a limited one. . . . More recently, Professor Langbein has extended the contractual approach, arguing that [t]rusts *are* contracts.’” See John H. Langbein, *The Contractarian Basis of Trusts*, 105 *Yale* 625 (1995) (emphasis added).” L. Waggoner, G. Alexander, M.L. Fellows, T. Gallanis, *Family Property Law*, p. 13-6 (4<sup>th</sup> Ed., 2006).

## G. Exculpation

(a) A term of a trust relieving a trustee of liability for breach of trust is unenforceable to the extent that the term relieves a 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 a beneficiary;  
or

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

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

(c) This section applies only to a term of a trust that may otherwise relieve a trustee from liability for a breach of trust. Except as provided in Section 111.0035, this section does not prohibit the settlor, by the terms of the trust, from expressly:

(1) Relieving the trustee from a duty or restriction imposed by this subtitle or by common law; or

(2) Directing or permitting the trustee to do or not to do an action that would otherwise violate a duty or restriction imposed by this subtitle or by common law.

See Texas Trust Code § 114.007.

## H. Forfeiture Clauses

In 2009, the legislature added Texas Trust Code § 112.038. As amended in 2011 and 2013, it now states:

A provision in a trust that would cause a forfeiture of or void an interest for bringing any court action, including contesting a trust, is enforceable unless in a court action determining whether the forfeiture clause should be

enforced, the person who brought the action contrary to the forfeiture clause establishes by a preponderance of the evidence that:

- (1) just cause existed for bringing the action; and
- (2) the action was brought and maintained in good faith.

Isn't that provision inconsistent with Section 111.0035? It would were it not for the addition of subsection 111.0035(b)(6) in 2009. But isn't that concept inconsistent with increased focus on settlor intent or the contract theory? And now a responsive amendment is proposed for Section 112.038. See SB 617, HB 1354 (2017).

#### I. Trustee With No Real Risk of Liability?

It is submitted that Texas law today permits the creation of a valid express trust even if the trustee has no real risk of personal liability during the administration of the trust. The most obvious example is the settlor/trustee of a well-drafted revocable trust. But couldn't a trust agreement be drafted in a way that eliminates any real risk of liability for a non-settlor trustee? In a revocable trust situation, it is the settlor's retained power of revocation that effectively eliminates the risk of liability of the settlor/trustee. In the other situations, granting to the non-settlor trustee, in the trustee's individual capacity, a general power of appointment (or perhaps even a non-general power) accomplishes arguably the same result.

The power of a revocation or a general power should not affect the trust's validity (recall in Chapter 181 of the Texas Property Code a power of revocation is a power of appointment). But either power obviously affects the trustee's responsibilities, and either power causes inclusion of the trust estate in the power holder's gross estate for tax purposes. It also exposes the trust estate to the power holder's creditors. See IX.C, *infra*. But either power apparently does not affect the validity of the trust.

Even if the trustee does not have a power of revocation or a general power of appointment, the terms of the trustee can apparently limit the trustee's duty to merely acting in good faith and in accordance with the purposes of the trust, thereby significantly reducing the trustee's risk of personal liability.

#### IV. **Today's Management Trust**

Waggoner, et al., quote extensively from Professor Langbein to explain how the concept of the express trust has evolved to what it is today.

Although the trust comes with a long historical pedigree, it has undergone a radical transformation in the past century. The core function of the trust has changed, giving rise both to the modern trust industry and to a profoundly altered legal regime that was necessary to support and govern

the industry. . . . The trust first developed from an age in which real estate was the principal form of wealth.

Today's trust has ceased to be a conveyancing device for land and has become, instead, a management device for holding a portfolio of financial assets. The management trust is a response to the radical change away from family real estate as the dominant form of personal wealth. . . . Most modern wealth takes the form of financial assets: equities, bonds, mutual fund shares, insurance contracts, pension and annuity interests and bank accounts. Today's trust typically holds a portfolio of these complex financial assets, which are contract rights against issuers. Such a portfolio requires skilled and active management. Investment decisions must be made and monitored, the portfolio rebalanced and proxies voted. . . . By contrast, under the old conveyancing trust that held ancestral land, the beneficiaries commonly lived on the land and managed it. The trustees were, in truth, more stakeholders than managers; they were, in effect, nominees, with no serious powers or duties. . . ." *Rise of the Management Trust*, 143 Tr. & Est. 52, 53, 57 (Oct. 2004) (footnotes omitted.)

The result of this evolutionary process is that today's trust is not the trust of the past. This change in the nature of the express trust affects not only the relative rights of beneficiaries and corresponding duties of trustees, but also the interests of third parties dealing with trustees.

## V. Irrevocability of Trusts

Common law courts very seldom allowed a trustee to vary from the terms of an irrevocable trust, especially if it affected the beneficiaries' relative rights. The courts were more liberal if the terms needing change related to the trust's "administrative" provisions, rather than its "distributive" provisions. In either event, a court might have invoked the "equitable doctrine of deviation" on the basis of unforeseen circumstances that were not anticipated and addressed within the terms of the trust, especially if it related to trust administration. See also Texas Trust Act § 46(C). *Amalgamated Transit Union, Local Division 1338 v. Dallas Public Transit Board*, 430 S.W.2d 107 (Tex. Civ. App. – Dallas 1968, *writ ref'd*), *cert. denied*, 396 U.S. 838 (1969).

In enacting the Texas Trust Code in 1984, the legislature adopted the more modern approach taken in Restatement (Second) Trusts, § 167 (1957), which granted courts more extensive powers to modify the terms of a trust. A 2005 amendment to the Texas Trust Code significantly liberalized the court's authority to modify and even terminate "irrevocable trusts." 2007 legislation authorized trustees to terminate "uneconomic" trusts. 2015 legislation authorized trustees to disclaim. See Texas Property Code §§ 240.007, 240.008.

The 2013 legislature authorized "decanting" of trusts, granting to "authorized" trustees the authority to "pour" trust assets into a new trust with different "terms of trust." The trustee's decanting power depends on the terms of the original trust, including whether the trustee has "full discretion" over principal distributions. See Texas Trust Code §§ 112.071-112.087. A 2017

legislative proposal would clarify that the grant of power to decant does not limit a beneficiary's right to bring an action for breach of trust. See SB 617, HB 2354 (2017).

2017 legislative proposals would authorize a court to reform an existing document to correct a scrivener's error or to qualify a distributee for governmental benefits. See SB 617, HB 1354 (2017).

A. Texas Trust Code (as enacted)

- (a) On the petition of a trustee or a beneficiary, a court may order that the trustee be changed, that the terms of the trust be modified, that the trustee be directed or permitted to do acts that are not authorized or that are forbidden by the terms of the trust, that the trustee be prohibited from performing acts required by the terms of the trust, or that the trust be terminated in whole or in part, if:
- (1) The purposes of the trust have been fulfilled or have become illegal or impossible to fulfill; or
  - (2) Because of circumstances not known to or anticipated by the settlor, compliance with the terms of the trust would defeat or substantially impair the accomplishment of the purposes of the trust. . . .

See Texas Trust Code § 112.054(a) (1984).

B. Judicial Modification/Termination (Currently)

- (a) On the petition of a trustee or a beneficiary, a court may order that the trustee be changed, that the terms of the trust be modified, that the trustee be directed or permitted to do acts that are not authorized or that are forbidden by the terms of the trust, that the trustee be prohibited from performing acts required by the terms of the trust, or that the trust be terminated in whole or in part, if:
- (1) The purposes of the trust have been fulfilled or have become illegal or impossible to fulfill;
  - (2) Because of circumstances not known to or anticipated by the settlor, the order will further the purposes of the trust;
  - (3) Modification of administrative, nondispositive terms of the trust is necessary or appropriate to prevent waste or avoid impairment of the trust's administration;
  - (4) The order is necessary or appropriate to achieve the settlor's tax objectives and is not contrary to the settlor's intentions; or
  - (5) Subject to Subsection (d):
    - (A) Continuance of the trust is not necessary to achieve any material purpose of the trust; or
    - (B) The order is not inconsistent with a material purpose of the trust.
- (b) The court shall exercise its discretion to order a modification or termination under Subsection (a) in the manner that confirms as nearly as possible to the probable intention of the settlor. The court shall consider spendthrift provisions as a factor in making its decision whether to modify or terminate, but the court

is not precluded from exercising its discretion to modify or terminate solely because the trust is a spendthrift trust.

- (c) The court may direct that an order described by Subsection (a)(4) has retroactive effect.
- (d) The court may not take the action permitted by Subsection (a)(5) unless all beneficiaries of the trust have consented to the order or are deemed to have consented to the order. A minor, incapacitated, unborn or unascertained beneficiary is deemed to have consented if a person representing the beneficiary's interest under Section 115.013(c) has consented or if a guardian ad litem appointed to represent the beneficiary's interest under Section 115.014 consents on the beneficiary's behalf.

See Texas Trust Code § 112.054 (eff. 2006). A 2017 legislative proposal would expressly grant the court to not only modify but to reform an existing trust. See SB 617, HB 1354 (2017).

#### C. Uneconomic Trusts

- (a) After notice to beneficiaries who are distributees or permissible distributees of trust income or principal or who would be distributees or permissible distributees of the interests of the distributees or the trust were to terminate and no powers of appointment were exercised, the trustee of a trust consisting of trust property having a total value of less than \$50,000 may terminate the trust if the trustee concludes after considering the purpose of the trust and the nature of the trust assets that the value of the trust property is insufficient to justify the continued cost of administration. . . .

See Texas Trust Code § 112.059 (eff. 2007)

#### D. Decanting Full Discretion

- (a) An authorized trustee who has the full discretion to distribute the principal of a trust may distribute all or part of the principal of that trust in favor of a trustee of a second trust for the benefit of one or more current beneficiaries of the first trust who are eligible to receive income or principal from the trust and for the benefit of one or more successor or presumptive remainder beneficiaries of the first trust who are eligible to receive income or principal from the trust. . . .

See Texas Trust Code § 112.072 (eff. 2013)

#### E. Decanting Limited Discretion

- (a) An authorized trustee who has limited discretion to distribute the principal of a trust may distribute all or part of the principal of that trust in favor of a trustee of a second trust as provided by this section. . . .

See Texas Trust Code § 112.073 (eff. 2013)

## **VI. Income v. Principal/Investments**

From the Harvard College "prudent man rule" to the "modified" version of the prudent man rule found in the Texas Trust Act, trustees were expected to invest the trust estate in a manner that preserved the principal while generating a reasonable amount of income. As enacted, the Texas Trust Code continued this rather conservative standard, but said trust investments were to be evaluated in relation to the portfolio as a whole, rather than as a single investment. Restatement (Third) Trusts and the Uniform Prudent Investor Act later adopted the "modern portfolio theory" and required trustees to invest as "prudent investors" as part of an overall portfolio-based investment plan which incorporates suitable risk and return objectives.

Texas enacted its own version of the Uniform Prudent Investor Act in 2003, effective January 1, 2004. That legislation also allowed delegation of investment responsibilities to a third party. At the same time, Texas enacted its own version of the Uniform Principal and Income Act, including new fiduciary accounting rules. That Act also introduced the trustee's "power of adjustment," if the trustee is subject to the "UPIA twins." The application of the "UPIA twins" is, however, subject to the settlor's intent as expressed within the terms of the trust agreement.

### **A. The Prudent Man Rule**

In acquiring, investing, reinvesting, exchanging, retaining, selling, supervising and managing property for the benefit of another, the trustee shall exercise the judgment and care under the circumstances then prevailing, which men of ordinary prudence, discretion and intelligence exercise in the management of their own affairs, not in regard to speculation but in regard to the permanent disposition of their funds, considering the probable income therefrom, as well as the probable safety of their capital. . . .

See Texas Trust Act § Forty-Six.

### **B. The Prudent Person Rule**

Unless the terms of the trust instrument provide otherwise, in acquiring, investing, reinvesting, exchanging, retaining, selling, supervising, and managing trust property a trustee shall exercise the judgment and care under the current circumstances that persons of ordinary prudence, discretion and intelligence exercise in the management of their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income from as well as the probable increase in value and the safety of their capital. . . .

See Texas Trust Code § 113.056 (Repealed 2003).

C. The Prudent Investor Rule

Unless the terms of the trust instrument provide otherwise, and subject to the investment standards provided by this subtitle and any investment standards provided by the trust instrument, the trustee may invest all or part of the trust assets in an investment vehicle authorized for the collective investment of trust funds pursuant to Part 9, Title 12, of the Code of Federal Regulations.

See Texas Trust Code § 113.056 (2000).

- (a) Effective January 1, 2004, a trustee shall invest and manage trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill and caution.

See Texas Trust Code § 117.004.

D. Trustees With Special Skills

The 2003 legislation also provided that a trustee who has special skills or expertise, or is named trustee in reliance upon the trustee's representation that the trustee has special skills or expertise, has a duty to use those special skills or expertise. See Texas Trust Code § 117.004(f).

E. Trustee's Power to Adjust

- (a) A trustee may adjust between principal and income to the extent the trustee considers necessary if the trustee invests and manages trust assets as a prudent investor, the terms of the trust describe the amount that may or must be distributed to a beneficiary by referring to the trust's income, and the trustee determines, after applying the rules in Section 116.004(a), that the trustee is unable to comply with Section 116.004(b). The power to adjust conferred by this subsection includes the power to allocate all or part of a capital gain to trust income. . . .
- (c) A trustee may not make an adjustment: . . .
  - (6) If the trustee is a beneficiary of the trust; or
  - (7) If the trustee is not a beneficiary, but the adjustment would benefit the trustee directly or indirectly. . . .

- (f) Terms of a trust that limit the power of a trustee to make an adjustment between principal and income do not affect the application of this section unless it is clear from the terms of the trust that the terms are intended to deny the trustee the power of adjustment conferred by Subsection (a).

See Texas Trust Code § 116.005.

## **VII. Shifting Responsibility/Excusing Breach**

Early common law prohibited a trustee from delegating the trustee's responsibilities. A trustee's responsibilities were deemed to be personal to the trustee. Later, trustees were permitted to delegate ministerial responsibilities, but not any responsibilities that required the exercise of the trustee's judgment. The Texas Trust Act permitted a trustee to delegate certain responsibilities if it was reasonable under the circumstances. Subsequent legislation has dramatically changed the law relating to delegation and the trustee's related fiduciary duties. Modern trust law even permits the settlor to shift trust responsibilities to others. The roles of co-trustees, trust protectors and directed trustees present interesting fiduciary-related issues.

### A. Texas Trust Code, Generally

A trustee may employ attorneys, accountants, agents, including investment agents, and brokers reasonably necessary in the administration of the trust estate. See Texas Trust Code § 113.018. SB 617, HB 1354 (2017) would significantly expand a trustee's ability to delegate related to real estate transactions.

### B. Investment/Management

(a) A trustee may delegate investment and management functions that a prudent trustee of comparable skills could properly delegate under the circumstances. The trustee shall exercise reasonable care, skill and caution in:

- (1) Selecting an agent;
- (2) Establishing the scope and terms of the delegation, consistent with the purposes and terms of the trust; and
- (3) Periodically reviewing the agent's actions in order to monitor the agent's performance and compliance with the terms of the delegation.

(b) In performing a delegated function, an agent owes a duty to the trust to exercise reasonable care to comply with the terms of the delegation.

(c) A trustee who complies with the requirements of Subsection (a) is not liable to the beneficiaries or to the trust for the decisions or actions of the agent to whom the function was delegated, unless:

- (1) The agent is an affiliate of the trustee; or
- (2) Under the terms of the delegation:
  - (A) The trustee or a beneficiary of the trust is required to arbitrate disputes with an agent; or



- (B) The period for bringing an action by the trustee or a beneficiary of the trust with respect to an agent's actions is shortened from that which is applicable to trustees under the law of this state.
- (c) By accepting the delegation of a trust function from the trustee of a trust that is subject to the law of this state, an agent submits to the jurisdiction of the courts of this state.

See Texas Trust Code § 117.011.

C. Co-Trustees

- (a) A trustee who does not join in an action of a co-trustee is not liable for the co-trustee's actions, unless the trustee does not exercise reasonable care as provided by Subsection (b).
- (b) Each trustee shall exercise reasonable care to:
  - (1) Prevent a co-trustee from committing a serious breach of trust; and
  - (2) Compel a co-trustee to redress a serious breach of trust.
- (c) Subject to Subsection (b), a dissenting trustee who joins in an action at the direction of the majority of the trustees and who has notified any co-trustee of the dissent in writing at or before the time of the action is not liable for the action.

See Texas Trust Code § 114.006.

D. Directed Trustees

- (a) In this section:
  - (1) "Advisor" includes protector.
  - (2) "Investment decision" means, with respect to any investment, the retention, purchase, sale, exchange, tender, or other transaction affecting the ownership of the investment or rights in the investment and, with respect to a nonpublicly traded investment, the valuation of the investment.
- (b) This section does not apply to a charitable trust as defined by Section 123.001.
- (c) For purposes of this section, an advisor with authority with respect to investment decisions is an investment advisor.
- (d) A protector has all the power and authority granted to the protector by the trust terms, which may include:
  - (1) the power to remove and appoint trustees, advisors, trust committee members, and other protectors;
  - (2) the power to modify or amend the trust terms to achieve favorable tax status or to facilitate the efficient administration of the trust; and
  - (3) the power to modify, expand, or restrict the terms of a power of appointment granted to a beneficiary by the trust terms.
- (e) If the terms of a trust give a person the authority to direct, consent to, or disapprove a trustee's actual or proposed investment decisions, distribution

decisions, or other decisions, the person is considered to be an advisor and a fiduciary when exercising that authority except that the trust terms may provide that an advisor acts in a nonfiduciary capacity.

(f) A trustee who acts in accordance with the direction of an advisor, as prescribed by the trust terms, is not liable, except in cases of wilful misconduct on the part of the trustee so directed, for any loss resulting directly or indirectly from that act.

(g) If the trust terms provide that a trustee must make decisions with the consent of an advisor, the trustee is not liable, except in cases of wilful misconduct or gross negligence on the part of the trustee, for any loss resulting directly or indirectly from any act taken or not taken as a result of the advisor's failure to provide the required consent after having been requested to do so by the trustee.

(h) If the trust terms provide that a trustee must act in accordance with the direction of an advisor with respect to investment decisions, distribution decisions, or other decisions of the trustee, the trustee does not, except to the extent the trust terms provide otherwise, have the duty to:

- (1) monitor the conduct of the advisor;
- (2) provide advice to the advisor or consult with the advisor; or
- (3) communicate with or warn or apprise any beneficiary or third party concerning instances in which the trustee would or might have exercised the trustee's own discretion in a manner different from the manner directed by the advisor.

(i) Absent clear and convincing evidence to the contrary, the actions of a trustee pertaining to matters within the scope of the advisor's authority, such as confirming that the advisor's directions have been carried out and recording and reporting actions taken at the advisor's direction, are presumed to be administrative actions taken by the trustee solely to allow the trustee to perform those duties assigned to the trustee under the trust terms, and such administrative actions are not considered to constitute an undertaking by the trustee to monitor the advisor or otherwise participate in actions within the scope of the advisor's authority.

See Texas Trust Code § 114.0031 (2015).

#### E. Exculpation

(a) A term of a trust relieving a trustee of liability for breach of trust is unenforceable to the extent that the term relieves a 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 a beneficiary;or

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

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

(c) This section applies only to a term of a trust that may otherwise relieve a trustee from liability for a breach of trust. Except as provided in Section 111.0035, this section does not prohibit the settlor, by the terms of the trust, from expressly:

- (1) Relieving the trustee from a duty or restriction imposed by this subtitle or by common law; or
- (2) Directing or permitting the trustee to do or not to do an action that would otherwise violate a duty or restriction imposed by this subtitle or by common law.

See Texas Trust Code § 114.007.

#### F. Releases

(a) A beneficiary who has full legal capacity and is acting on full information may relieve a trustee from any duty, responsibility, restriction or liability as to the beneficiary that would otherwise be imposed on the trustee by this subtitle, including liability for past violations.

(b) The release must be in writing and delivered to the trustee.

See Texas Trust Code § 114.005.

#### G. Virtual Representation

(a) A written agreement between a trustee and a beneficiary, including a release, consent, or other agreement relating to a trustee's duty, power, responsibility, restriction, or liability, is final and binding on the beneficiary and any person represented by a beneficiary as provided by this section if:

- (1) The instrument is signed by the beneficiary;
- (2) The beneficiary has legal capacity to sign the instrument;  
and
- (3) The beneficiary has full knowledge of the circumstances surrounding the agreement.

(b) A written agreement signed by a beneficiary who has the power to revoke the trust or the power to appoint, including the power to appoint through a power of amendment, the income or principal of the trust to or for the benefit of the beneficiary, the beneficiary's creditors, the beneficiary's estate, or the creditors of the beneficiary's estate is final and binding on any person who takes under the power of appointment or who takes in default if the power of appointment is not executed.

(c) A written instrument is final and binding on a beneficiary who is a minor if:

- (1) The minor's parent, including a parent who is also a trust beneficiary, signs the instrument on behalf of the minor;
- (2) No conflict of interest exists; and
- (3) No guardian, including a guardian ad litem, has been appointed to act on behalf of the minor.

(d) A written instrument is final and binding on an unborn or unascertained beneficiary if a beneficiary who has an interest substantially identical to the interest of

the unborn or unascertained beneficiary signs the instrument. For purposes of this subsection, an unborn or unascertained beneficiary has a substantially identical interest only with a trust beneficiary from whom the unborn or unascertained beneficiary descends.

(e) This section does not apply to a written instrument that modifies or terminates a trust in whole or in part unless the instrument is otherwise permitted by law.

See Texas Trust Code § 114.032.

### **VIII. Third Party's Duty of Inquiry**

At common law and in Texas even after the enactment of the Texas Trust Act, a third party dealing with a known trustee generally had the affirmative duty to confirm that the trustee had the authority to engage in the transaction. If the trustee did not have the power to enter into the transaction, not only did the trustee breach its fiduciary duty owing to the beneficiary, but the third party was at risk of having the transaction set aside and even having personal liability. See William LaPiana, *Inside Wills and Trusts*, pps. 370, 371 (Wolters Kluwer 2012).

The law generally favored the interests of the beneficiary over the third party. The “Blind Trust Act,” originally located in now repealed Article 7425a, was incorporated into Texas Trust Act § 8 (7425b-8) and was intended to afford certain third parties protection from failing to comply with the duty of inquiry. When eventually incorporated into the Texas Trust Code, the “Blind Trust Act” language was modified in response to a number of Texas cases which had diminished its effectiveness. Subsequent legislation appears to have shifted the law even more in favor of the third party relative to the beneficiary. This shift in favor of third parties has also found its way into Texas independent administrations. See Texas Estates Code § 402.053 (eff. 2014).

#### **A. Today's Blind Trust Act**

If property is conveyed or transferred to a trustee in trust but the conveyance or transfer does not identify the trust or disclose the names of the beneficiaries, the trustee may convey, transfer, or encumber the title of the property without subsequent question by a person who claims to be a beneficiary under the trust or who claims by, through or under an undisclosed beneficiary.

See Texas Trust Code § 114.082.

#### **B. Third Parties, Generally**

(a) A person who deals with a trustee in good faith and for fair value actually received by the trust is not liable to the trustee or the beneficiaries of the trust if the trustee has exceeded the trustee's authority in dealing with the person.

(b) A person other than a beneficiary is not required to inquire into the extent of the trustee's powers or the propriety of the exercise of those powers if the person:

(1) Deals with the trustee in good faith; and

(2) Obtains:

(A) A certification of trust described by Section 114.086;  
or

(B) A copy of the trust instrument.

(c) A person who in good faith delivers money or other assets to a trustee is not required to ensure the proper application of the money or other assets.

(d) A person other than a beneficiary who in good faith assists a former trustee, or who in good faith and for value deals with a former trustee, without knowledge that the trusteeship has terminated, is protected from liability as if the former trustee were still a trustee.

(e) Comparable protective provisions of other laws relating to commercial transactions or transfer of securities by fiduciaries prevail over the protection provided by this section.

See Texas Trust Code § 114.081. See proposed 2017 amendments to Section 113.018 in SB 617, HB 1354 (2017).

### C. Trust Certificates

(a) As an alternative to providing a copy of the trust instrument to a person other than a beneficiary, the trustee may provide to the person a certification of trust containing the following information:

(1) A statement that the trust exists and the date the trust instrument was executed;

(2) The identity of the settlor;

(3) The identity and mailing address of the currently acting trustee;

(4) One or more powers of the trustee or a statement that the trust powers include at least all the powers granted a trustee by Subchapter A, Chapter 113;

(5) The revocability or irrevocability of the trust and the identity of any person holding a power to revoke the trust;

(6) The authority of co-trustees to sign or otherwise authenticate and whether all or less than all of the co-trustees are required in order to exercise powers of the trustee; and

(7) The manner in which title to trust property should be taken.

(b) A certification of trust may be signed or otherwise authenticated by any trustee.

(c) A certification of trust must state that the trust has not been revoked, modified, or amended in any manner that would cause the representations contained in the certification to be incorrect.

(d) A certification of trust:

- (1) Is not required to contain the dispositive terms of a trust; and
- (2) May contain information in addition to the information required by Subsection (a).

(e) A recipient of a certification of trust may require the trustee to furnish copies of the excerpts from the original trust instrument and later amendments to the trust instrument that designate the trustee and confer on the trustee the power to act in the pending transaction.

(f) A person who acts in reliance on a certification of trust without knowledge that the representations contained in the certification are incorrect is not liable to any person for the action and may assume without inquiry the existence of the facts contained in the certification.

(g) If a person has actual knowledge that the trustee is acting outside the scope of the trust, and the actual knowledge was acquired by the person before the person entered into the transaction with the trustee or made a binding commitment to enter into the transaction, the transaction is not enforceable against the trust.

(h) A person who in good faith enters into a transaction relying on a certification of trust may enforce the transaction against the trust property as if the representations contained in the certification are correct. This section does not create an implication that a person is liable for acting in reliance on a certification of trust that fails to contain all the information required by Subsection (a). A person's failure to demand a certification of trust does not:

- (1) Affect the protection provided to the person by Section 114.081; or
- (2) Create an inference as to whether the person has acted in good faith.

(i) A person making a demand for the trust instrument in addition to a certification of trust or excerpts as described by Subsection (e) is liable for damages if the court determines that the person did not act in good faith in making the demand.

(j) This section does not limit the right of a person to obtain a copy of the trust instrument in a judicial proceeding concerning the trust.

(k) This section does not limit the rights of a beneficiary of the trust against the trustee.

See Texas Trust Code § 114.086.

## **IX. Spendthrift Trusts**

Prior to the enactment of the Texas Trust Code, the validity of “spendthrift trusts” was found in Texas case law. The Texas Trust Code’s spendthrift provisions were based on Restatement (Second) Trusts, §§ 152, 153 (1957) and were consistent with preexisting Texas case law.

Restatement (Third) Trusts took the position that the protection from the beneficiary’s creditors that a spendthrift provision would otherwise provide is lost if the beneficiary is serving as the trustee with the power to make distributions of principal to the beneficiary/trustee, or if the

beneficiary has a power to appoint the beneficiary trust principal, even if the power is limited by an “ascertainable standard” (such as health, education, maintenance or support – the “HEMS standard”). See Restatement (Third) Trusts § 58 commentary. In 2005, the Texas legislature responded to the Restatement's position with an amendment to the Texas Trust Code's spendthrift provision.

Limiting a general power of appointment to the HEMS standard also generally excludes the property subject to the power from inclusion in the deceased power holder's gross estate for estate tax purposes.

A. Texas Trust Code

(a) A settlor may provide in the terms of the trust that the interest of a beneficiary in the income or in the principal or in both may not be voluntarily or involuntarily transferred before payment or delivery of the interest to the beneficiary by the trustee.

(b) A declaration in a trust instrument that the interest of a beneficiary shall be held subject to a “spendthrift trust” is sufficient to restrain voluntary or involuntary alienation of the interest by a beneficiary to the maximum extent permitted by this subtitle.

(c) A trust containing terms authorized under Subsection (a) or (b) of this section may be referred to as a spendthrift trust.

(d) If the settlor is also a beneficiary of the trust, a provision restraining the voluntary or involuntary transfer of the settlor's beneficial interest does not prevent the settlor's creditors from satisfying claims from the settlor's interest in the trust estate. A settlor is not considered a beneficiary of a trust solely because:

- (1) a trustee who is not the settlor is authorized under the trust instrument to pay or reimburse the settlor for, or pay directly to the taxing authorities, any tax on trust income or principal that is payable by the settlor under the law imposing the tax; or
- (2) the settlor's interest in the trust was created by the exercise of a power of appointment by a third party.

(e) A beneficiary of the trust may not be considered a settlor merely because of a lapse, waiver, or release of:

- (1) a power described by Subsection (f); or
- (2) the beneficiary's right to withdraw a part of the trust property to the extent that the value of the property affected by the lapse, waiver, or release in any calendar year does not exceed the greater of the amount specified in:
  - (A) Section 2041(b)(2) or 2514(e), Internal Revenue Code of 1986; or
  - (B) Section 2503(b), Internal Revenue Code of 1986.

(f) A beneficiary of the trust may not be considered to be a settlor, to have made a voluntary or involuntary transfer of the beneficiary's interest in the trust, or to have the power to make a voluntary or involuntary transfer of the beneficiary's interest in the trust, merely because the beneficiary, in any capacity, holds or exercises:

- (1) a presently exercisable power to:
  - (A) consume, invade, appropriate, or distribute property to or for the benefit of the beneficiary, if the power is:

- (i) exercisable only on consent of another person holding an interest adverse to the beneficiary's interest; or
  - (ii) limited by an ascertainable standard, including health, education, support, or maintenance of the beneficiary; or
  - (B) appoint any property of the trust to or for the benefit of a person other than the beneficiary, a creditor of the beneficiary, the beneficiary's estate, or a creditor of the beneficiary's estate;
  - (2) a testamentary power of appointment; or
  - (3) a presently exercisable right described by Subsection (e)(2).
- (g) For the purposes of this section, property contributed to the following trusts is not considered to have been contributed by the settlor, and a person who would otherwise be treated as a settlor or a deemed settlor of the following trusts may not be treated as a settlor:
- (1) an irrevocable inter vivos marital trust if:
    - (A) the settlor is a beneficiary of the trust after the death of the settlor's spouse; and
    - (B) the trust is treated as:
      - (i) qualified terminable interest property under [Section 2523\(f\), Internal Revenue Code](#) of 1986; or
      - (ii) a general power of appointment trust under [Section 2523\(e\), Internal Revenue Code](#) of 1986;
  - (2) an irrevocable inter vivos trust for the settlor's spouse if the settlor is a beneficiary of the trust after the death of the settlor's spouse; or
  - (3) an irrevocable trust for the benefit of a person:
    - (A) if the settlor is the person's spouse, regardless of whether or when the person was the settlor of an irrevocable trust for the benefit of that spouse; or
    - (B) to the extent that the property of the trust was subject to a general power of appointment in another person.
- (h) For the purposes of Subsection (g), a person is a beneficiary whether named a beneficiary:
- (1) under the initial trust instrument; or
  - (2) through the exercise of a limited or general power of appointment by:
    - (A) that person's spouse; or
    - (B) another person.

See Texas Trust Code § 112.035.

**B. Internal Revenue Code**

- . . . General Power of Appointment – The term “General Power of Appointment” means a power which is exercisable in favor of the decedent, his estate, his creditors or the creditors of his estate; except that:
- (A) A power to consume, invade or appropriate property for the benefit of the decedent which is limited by an ascertainable standard relating to the health, education, support or



maintenance of the decedent shall not be deemed a general power of appointment. . . .

Lapse of Power – The lapse of a power of appointment created after October 21, 1942, during the life of the individual possessing the power shall be considered a release of such power. The preceding sentence shall apply with respect to the lapse of powers during any calendar year only to the extent that the property, which could have been appointed by exercise of such lapsed powers, exceeded in value, at the time of such lapse, the greater of the following amounts:

- (A) \$5,000, or
- (B) Five percent of the aggregate value, at the time of such lapse, of the assets out of which, or the proceeds of which, the exercise of the lapsed powers could have been satisfied. . . .

See Internal Revenue Code § 2041.

C. Limitation on Powers of Trustee/Beneficiary

2009 legislation generally provides that, if the terms of a trust grant a trustee who is also a beneficiary the power to make discretionary distributions to the trustee/beneficiary and the power is not limited by the HEMS standard, the trustee/beneficiary can only exercise the power in accordance with the HEMS standard. Such a trustee/beneficiary is also prohibited from exercising the power in a manner that satisfies the trustee/beneficiary's legal obligation to support another. See Texas Trust Code § 112.028.

**X. Rule Against Perpetuities**

Another modern trend is legislation in many states that has either repealed the rule against perpetuities or significantly amended it as it applies to non-charitable trusts. The result in those states has been the creation of what has been referred to as "dynasty trusts" by commentators. The typical dynasty trust is created and funded so that it is exempt from the generation-skipping transfer tax. The rule against perpetuities is still a part of Texas law, but legislation is pending in the 2017 Legislature (as it had in a number of previous sessions) at the time this paper was submitted that would modify the Texas rule and allow private express trusts to last for 300 years. See HB 2842 (2017). Now (at the time of the presentation) that the session is over, another question is: "Has Texas become part of that trend?"