TRUSTEE COMPENSATION AND FORFEITURE IN TEXAS

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David has specialized in estate and trust disputes including: trust modification/clarification/reformation, trustee resignation/removal, breach of fiduciary duty and related claims, accountings, will contests, mental competency issues, and undue influence. David's recent trial experience includes:

Represented a trustee in federal class action suit where trust beneficiaries challenged whether it was the authorized trustee of over 220 trusts;

Represented trustees regarding claims of mismanagement of assets;

Represented a trustee who filed suit to modify three trusts to remove a charitable beneficiary that had substantially changed operations;

Represented a trustee regarding dispute over the failure to make distributions;

Represented a trustee/bank regarding a negligence claim arising from investments from an IRA account;

Represented individuals in will contests arising from claims of undue influence and mental incompetence;

Represented estate representatives against claims raised by a beneficiary for breach of fiduciary duty;

Represented beneficiaries against estate representatives for breach of fiduciary duty and other related claims; and

Represented estate representatives, trustees, and beneficiaries regarding accountings and related claims.

David is one of twenty attorneys in the state (of the 84,000 licensed) that has the triple Board Certification in Civil Trial Law, Civil Appellate, and Personal Injury Trial Law by the Texas Board of Legal Specialization. Additionally, David was a member of the Civil Trial Law Commission of the Texas Board of Legal Specialization. This commission writes and grades the exam for new applicants for civil trial law certification. David is a graduate of Baylor University School of Law, *Magna Cum Laude*, and Baylor University, B.B.A. in Accounting.

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I. INTRODUCTION

In early English law, trustees were not allowed any compensation. It was believed that injecting payment into his or her work would create a selfish interest that may redirect a trustee from his duty to look out for the best interests of the beneficiary. This was also the rule in the United States initially. However, this prohibition was changed over time. *Schriver v. Frommel*, 1919, 210 S.W. 165, 183 Ky. 597.

Now, trustees are usually entitled to reasonable compensation for their work in managing trust assets. Due to the inherent conflict of interest in a trustee paying itself compensation from trust assets, there are a variety of different issues that arise in this area. This article is intended to discuss many of the common issues that arise when a trustee seeks compensation and also addresses the concept of compensation forfeiture.

II. CONCEPT OF A FIDUCIARY RELATIONSHIP

In considering issues that arise from trustee compensation, one should first consider what the fiduciary relationship means. A fiduciary owes its principal one of the highest duties known to law—this is a very special relationship. *See, e.g., Ditta v. Conte*, 298 S.W.3d 187, 191 (Tex. 2009) ("A fiduciary 'occupies a position of peculiar confidence towards another.'… Because a trustee's fiduciary role is a status, courts acting within their explicit statutory discretion should be authorized to terminate the trustee's relationship with the trust at any time, without the application of a limitations period."); *Rawhide Mesa-Partners, Ltd. v. Brown McCarroll, L.L.P.*, 344 S.W.3d 56, 60 (Tex. App.—Eastland 2011, no pet.) ("A fiduciary duty is the highest duty recognized by law.").

The term "fiduciary relationship" means "legal relations between parties created by law or by the nature of the contract between them where equity implies confidence and reliance." *Peckham v. Johnson,* 98 S.W.2d 408, 416 (Tex. Civ. App.—Fort Worth 1936), *aff'd sub nom.*, 132 Tex. 148, 120 S.W.2d 786 (1938). The expression of "fiduciary relation" is one of broad meaning, including both technical fiduciary relations and those informal relations that exist whenever one person trusts and relies upon another. *Texas Bank & Trust Co. v. Moore*, 595 S.W.2d 502, 507 (Tex. 1980); *Peckham,* 98 S.W.2d at 416.

A fiduciary duty is a formal, technical relationship of confidence and trust imposing higher duties upon the fiduciary as a matter of law. *Central Sav. & Loan Ass'n v. Stemmons N.W. Bank, N.A.*, 848 S.W.2d 232, 243 (Tex. App.—Dallas 1992, no writ). The duty owed is one of loyalty and good faith, strict integrity, and fair and honest dealing. *Douglas v. Aztec Petroleum Corp.*, 695 S.W.2d 312, 318 (Tex. App.—Tyler 1985, no writ). When parties enter a fiduciary relationship, the fiduciary consents to have its conduct toward the other measured by high standards of loyalty as exacted by courts of equity. *Courseview, Inc. v. Phillips Petroleum Co.*, 158 Tex. 397, 312 S.W.2d 197, 205 (Tex. 1957). The term "fiduciary" refers to integrity and fidelity. *Kinzbach Tool Co. v. Corbett-Wallace Corp.*, 138 Tex. 565, 160 S.W.2d 509, 512 (Tex. 1942). The law requires more of a fiduciary than simply arms-length marketplace ethics. *Id*. at 514.

III. DUTY OF LOYALTY

In analyzing a trustee's right to compensation, that right is measured against a trustee's duty of loyalty.

A. Statutory Authority for Duty Of Loyalty

After reviewing the trust document, a trustee should be aware of the statutory duty of loyalty. Though the Texas Property Code does not go into much detail about a trustee's duties, it does provide: "A trustee shall invest and manage the trust assets solely in the interest of the beneficiaries." Tex. Prop. Code. Ann. § 117.007. The Texas Property Code also provides that a trustee is accountable to a beneficiary for the trust property and for any profit made by the trustee through or arising out of the administration of the trust, even though the profit does not result from a breach of trust. Tex. Prop. Code §114.001(a). Therefore, the Texas Property Code does set forth a general duty of loyalty owed by a trustee to a beneficiary.

B. Common-Law Duties of Loyalty

The Texas Property Code advises that trustees must follow the common law regarding its duties to beneficiaries. "A trustee shall administer the trust in good faith 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, a trustee shall perform all of the duties imposed on trustees by the common law." Tex. Prop. Code § 113.051. Under the common law, a trustee owes a trust beneficiary an unwavering duty of good faith, loyalty, and fidelity over the trust's affairs and its corpus.

To uphold its duty of loyalty, a trustee must meet a sole interest standard and handle trust property solely for the benefit of the beneficiaries. Tex. Prop. Code § 117.007; *InterFirst Bank Dallas, N.A. v. Risser*, 739 S.W.2d 882, 898 (Tex. App.—Texarkana 1987, no writ). This sole interest standard can be contrasted with the best interest standard for registered investment advisors, where an advisor does not violate the duty of loyalty merely because its conduct furthers its own interest.

For example, in *Slay v. Burnett Trust*, the Texas Supreme Court found a breach of loyalty where trustees loaned funds to a venture in which the trustees had an ownership interest. 187 S.W.2d 377 (Tex. 1945). Profits for the venture were divided between the trustees. The Court stated:

> It is a well-settled rule that a trustee can make no profit out of the trust. The rule in such case springs from his duty to protect the interests of the estate, and not to permit his personal interest in any wise to conflict with his duty in that respect. The intention is to provide against any possible selfish interest exercising an influence which can interfere with the faithful discharge of the duty which is owing in a fiduciary capacity.

Id. The Court noted: "Funds of the Trust were loaned and used to make the investment and to enter upon the venture. The Trust had all of the risk of loss and the parties named had all of the opportunity for profit." *Id*.

In *InterFirst Bank Dallas, N.A. v. Risser*, the court commented on the sole-interest standard: "The trustee holds a duty of loyalty to the beneficiaries to administer the affairs of the trust in the interest of the beneficiaries alone, and to exclude from consideration its own advantage as well as the welfare of third persons." 739 S.W.2d 882, 898 (Tex. App.—Texarkana 1987, no writ) (citing G. G. BOGERT & G. T. BOGERT, LAW OF TRUSTS § 95 (5th ed. 1973)). *See also Humane Soc'y of Austin & Travis County v. Austin Nat'l Bank*, 531 S.W.2d 574, 577 (Tex. 1975); *Snyder v. Cowell*, No. 08-01-00444-CV, 2003 Tex. App. LEXIS 3139, 2003 WL 1849145 (Tex. App.—El Paso Apr. 10, 2003, no pet.); *Lesikar v. Rappeport*, 33 S.W.3d 282, 297 (Tex. App.—Texarkana 2000, pet. denied); *Mainland Sav. Assn. v. Cothran*, 1985 Tex. App. LEXIS 12765 (Tex. App.—Houston [1st Dist.] Dec. 5, 1985, no pet.); *Crenshaw v. Swenson*, 611 S.W.2d 886 (Tex. Civ. App.—Austin 1980, writ ref'd n.r.e.). More recently, one court of appeals has held: "a trustee's duty of loyalty prohibits him from using the advantage of his position to gain any benefit for himself at the expense of his trust and from placing himself in any position where his self-interest will or may conflict with his obligations as trustee." *Musquiz v. Keesee*, No. 07-15-00461-CV, 2017 Tex. App. LEXIS 9214 (Tex. App.—Amarillo September 28, 2017, pet. denied). So, a trustee generally cannot obtain any benefit from its role as a fiduciary other than direct and reasonable compensation.

C. Restatement Guidance on Duty of Loyalty

The author relies on the Restatement of Trusts in many aspects of trust law. Texas courts routinely cite to the Restatement of Trusts as authority in trust-related issues. *Westerfeld v. Huckaby*, 474 S.W.2d 189 (Tex. 1971); *Messer v. Johnson*, 422 S.W.2d 908 (Tex. 1968); *Mason v. Mason*, 366 S.W.2d 552, 554-55 (Tex. 1963); *Lee v. Rogers Agency*, 517 S.W.3d 137, 160-61 (Tex. App.—Texarkana 2016, pet. denied); *Woodham v. Wallace*, No. 05-11-01121-CV, 2013 Tex. App. LEXIS 50 (Tex. App.—Dallas January 2, 2013, no pet.); *Wolfe v. Devon Energy Prod. Co. LP*, 382 S.W.3d 434, 446 (Tex. App.—Waco 2012, pet. denied); *Longoria v. Lasater*, 292 S.W.3d 156, 168 (Tex. App.—San Antonio 2009, pet. denied).

The Restatement (Third) of Trusts discusses the concept of a trustee's duty of loyalty thusly:

> (1) Except as otherwise provided in the terms of the trust, a trustee has a duty to administer the trust solely in the interest of the beneficiaries, or solely in furtherance of its charitable purpose.
>
> (2) Except in discrete circumstances, the trustee is strictly prohibited from engaging in transactions that involve self-dealing or that otherwise involve or create a conflict between the trustee's fiduciary duties and personal interests.
>
> (3) Whether acting in a fiduciary or personal capacity, a trustee has a duty in dealing with a beneficiary to deal fairly and to communicate to the beneficiary all material facts the trustee knows or should know in connection with the matter.
>
> ….
>
> Perhaps more subtle, but broader in application, is the general requirement that trustees act solely in the interest of the beneficiary in matters of trust administration. Furthermore,

a trustee must refrain, whether in fiduciary or personal dealings with third parties, from transactions in which it is reasonably foreseeable that the trustee's future fiduciary conduct might be influenced by considerations other than the best interests of the beneficiaries.

In transactions that violate the trustee's duty of undivided loyalty, under the so-called "no further inquiry" principle it is immaterial that the trustee may be able to show that the action in question was taken in good faith, that the terms of the transaction were fair, and that no profit resulted to the trustee.

….

The fiduciary duty of undivided loyalty in the trust context, as stated in Subsection (1) and amplified in Subsection (2), is particularly intense so that, in most circumstances, its prohibitions are absolute for prophylactic reasons. The rationale begins with a recognition that it may be difficult for a trustee to resist temptation when personal interests conflict with fiduciary duty. In such situations, for reasons peculiar to typical trust relationships, the policy of the trust law is to prefer (as a matter of default law) to remove altogether the occasions of temptation rather than to monitor fiduciary behavior and attempt to uncover and punish abuses when a trustee has actually succumbed to temptation. This policy of strict prohibition also provides a reasonable circumstantial assurance (except as waived by the settlor or an affected beneficiary) that beneficiaries will not be deprived of a trustee's disinterested and objective judgment.

RESTATEMENT (THIRD) OF TRUSTS, § 78.

Accordingly, a trustee has a strict duty of loyalty concerning the trust's assets and the administration of the trust. This duty means that a trustee should generally only be concerned with the beneficiary's interest. A trustee cannot profit from its position as trustee, except for reasonable compensation for its work as trustee.

D. Trust Document Limitations On Duty of Loyalty

The first place to look for any trust question is the trust document. Generally, the trust document governs and should be followed. Tex. Prop. Code § 111.0035(b); 113.001. "The trustee shall administer the trust in good faith according to its terms and the Texas Trust Code." *Tolar v. Tolar*, No. 12-14-00228-CV, 2015 Tex. App. LEXIS 5119 (Tex. App.—Tyler May 20, 2015, no pet.).

It is common for settlors to execute trust documents that contain exculpatory clauses. An exculpatory clause is one that forgives the trustee for some action or inaction. Generally, these types of clauses are enforceable in Texas and can effectively limit a trustee's duty. *Dolan v. Dolan*, No. 01-07-00694-CV, 2009 Tex. App. LEXIS 4487 (Tex. App.—Houston [1st Dist.] June 18, 2009, pet. denied). For example, in *Goughnour v. Patterson*, a court of appeals recently affirmed a summary judgment for a trustee arising from a beneficiary's claim that the trustee breached fiduciary duties by investing trust assets in a self-interested transaction. No. 12-17-00234-CV, 2019 Tex. App. LEXIS 1665 (Tex. App.—Tyler March 5, 2019, pet. filed). Among several defenses, the court held that the trustee proved that an exculpatory clause applied because the trustee did not act with gross negligence. *Id*.

In Texas, exculpatory clauses are strictly construed, and a trustee is relieved of liability only to the extent to which it is clearly provided that it will be excused. *Jewett v. Capital Nat. Bank of Austin*, 618 S.W.2d 109, 112 (Tex. App.—Waco 1981, writ ref'd n.r.e.); *Martin v. Martin*, 363 S.W.3d 221, 230 (Tex. App.—Texarkana 2012, pet. dism'd by agr.). *See also Price v. Johnston*, 638 S.W.2d 1, 4 (Tex. App.—Corpus Christi 1982, no writ) ("When a derogation of the [Texas Trust] Act hangs in the balance, a trust instrument should be strictly construed in favor of the beneficiaries"). For example, a court held that a clause that relieved a trustee from liability for "any honest mistake in judgment" did not forgive the trustee's acts of self-dealing. *Burnett v. First Nat. Bank of Waco*, 567 S.W.2d 873, 876 (Civ. App.—Tyler 1978, ref. n.r.e.).

There are also important statutory limitations on the effectiveness of exculpatory clauses. Texas Property Code Section 111.0035 provides that the terms of a trust may not limit a trustee's duty to respond to a demand for an accounting or to act in good faith. Tex. Prop. Code Ann. § 111.035(b)(4). Additionally, Texas Property Code Section 114.007 provides that an exculpatory clause is unenforceable to the extent that it relieves a trustee of liability for breaches done with bad faith, intent, or with reckless indifference to the interests of a beneficiary or for any profit derived by the trustee from a breach of trust. Tex. Prop. Code Ann. § 114.007.

So, a trust document may relieve a trustee from liability for negligent acts that do not result in a trustee deriving a profit from its breach. However, where a trustee intentionally pays itself too much or even negligently pays itself too much, an exculpatory clause may not protect the trustee from liability.

E. <u>Burden of Proof For Self-Interested Transactions</u>

Where a transaction involves self-dealing, a fiduciary in Texas usually has the burden of proof to establish that the transaction was fair to the principal. "Texas courts have applied a presumption of unfairness to transactions between a fiduciary and a party to whom he owes a duty of disclosure, thus casting upon the profiting fiduciary the burden of showing the fairness of the transactions." *Collins v. Smith*, 53 S.W.3d 832, 840 (Tex. App.—Houston [1st Dist.] 2001, no pet.) (citing *Texas Bank & Trust Co. v. Moore*, 595 S.W.2d 502, 507-08 (Tex. 1980)); *see also See Harrison v. Harrison Interests*, No. 14-15-00348-CV, 2017 Tex. App. LEXIS 1677 (Tex. App.—Houston [14th Dist.] February 28, 2017, no pet. history). Where a transaction between a fiduciary and a beneficiary is attacked, it is the fiduciary's burden of proof to establish the fairness of the transaction. *Fitz-Gerald v. Hull*, 150 Tex. 39, 49, 237 S.W.2d 256, 261 (1951); *Harrison*, 2017 Tex. App. LEXIS 1677. *See also Keck, Mahin & Cate v. Nat'l Union Fire Ins. Co.*, 20 S.W.3d 692, 699

(Tex. 2000) (considering whether a release agreement could bar claims arising from a fiduciary relationship and holding that the presumption of unfairness or invalidity applied).

A trustee compensating itself may be considered a self-interested transaction, and a trustee may have the burden to come forward and prove the fairness of the compensation. For example, in *Nickel v. Bank of Am.*, 290 F.3d 1134 (9th Cir. 2002), a bank (later acquired by Bank of America) improperly charged $24,000,000 in fees to various trusts. The court of appeals found that the district court's focus on the "speculative" nature of the disgorgement in question was incorrect. The court found that focusing on questions of traceability simply insulated the wrongdoer, the bank, and violated a rule of restitution, namely "if you take my money and make money with it, your profit belongs to me." *Id*. at 1138. The court also found that if the manner in which the bank had utilized the money was not traceable, there was a presumption that the bank was deriving profit from the funds. Thus, an appropriate remedy was a proportional share of the bank's profits for the period the funds were utilized. *Id*. at 1139. *See also Leigh v. Engle*, 727 F.2d 113 (7th Cir. 1984) (the court placed the burden of accounting on the defendant, an ERISA fiduciary, finding that there would be little reason to require restitution under ERISA's remedial provision, 29 U.S.C. § 1109(a), if "beneficiaries confronted an insurmountable obstacle in proving the extent of a fiduciary's profits," and placed "the burden of proof on the defendants here to ensure that the disgorgement remedy is effective."); *Rochow v. Life Ins. Co. of N. Am.*, 851 F. Supp. 2d 1090 (E.D. Mich March 23, 2012) (after plaintiff established reasonable approximation of improper profits, the burden shifted to defendant to disprove).

The beneficiary would not have any initial duty of proving that the compensation was unreasonable. So, if a beneficiary sues a trustee for breaching a fiduciary duty by over compensating itself, the trustee may be placed in the position of having the initial burden of presenting evidence that its compensation was reasonable and convincing a fact-finder of that fact. If this is the only issue in the case, then the trustee would be entitled to open and close the case (present evidence first and last) as it would have the burden of proof.

IV. <u>AUTHORITY FOR TRUSTEE COMPENSATION</u>

A. <u>Trustee Compensation</u>

1. <u>Reasonable Trustee Compensation Is Exception To Duty of Loyalty</u>

Reasonable trustee compensation is an exception to the sole-interest duty of loyalty. As the Restatement provides:

> Exception for trustee's compensation. The strict prohibitions against transactions by trustees involving conflicts between their fiduciary duties and personal interests do not apply to the trustee's taking of reasonable compensation for services rendered as trustee.

RESTATEMENT (THIRD) OF TRUSTS, § 78(c)(4). Uniform Trust Code § 802.

So, in general, a trustee does not violate its fiduciary duty by paying itself reasonable compensation. *In Matter of Nathan Trust*, 618 N.E.2d 1343 (Ind. App. 1993), *opinion vacated (result undisturbed)*, 638 N.E.2d

789 (1994) (allowing the trustees, on termination of a trust and over objection by a remainder beneficiary, to exercise their power to sell land held in the trust for the purpose of paying expenses and costs of administration, which included compensation and reimbursement for the trustees). *See also Nickel v. Bank of Am. Nat'l Trust & Sav. Ass'n*, 290 F.3d 1134, 1139(9th Cir. 2002), *as amended on denial of reh'g* (June 19, 2002) (finding bank did breach fiduciary duty of loyalty by overcompensating itself).

2. Trustee Should Review Trust Document For Right To Compensation

Regarding a trustee's right to compensation, a trustee should first look to the trust document. *See* RESTATEMENT (THIRD) OF TRUSTS, § 38(e) ("When the terms of a trust provide that the trustee is to receive a certain compensation or no compensation, the trustee's right to compensation is ordinarily governed by that provision. It is a question of interpretation whether such a provision applies also to successor trustees."). Trust documents may contain express compensation terms that dictate how a trustee is to be compensated. *Nations v. Ulmer*, 139 S.W.2d 352, 356 (Tex. Civ. App.—El Paso 1940, writ dism'd).

If the trust document does not allow any compensation to the trustee, then the trustee cannot compensate itself. *See* RESTATEMENT (THIRD) OF TRUSTS, § 38(f) ("the absence of compensation does not diminish the trustee's normal duties"). If the trust document has limits on compensation, then the trustee must strictly comply with those terms and not over compensate itself.

If a trust document has a set amount or formula for compensation, that circumstance substantially reduces any risk of a dispute regarding whether the compensation was reasonable. However, that may also limit the ability to retain and attract new qualified trustees. As society and investing becomes increasingly complicated, professional trustees are requiring larger amounts of compensation. The more they work, the more they want to get paid. If a trust has a set amount or formula for compensation, a professional trustee may be forced to resign unless all parties and/or a court agree to modify the trust to allow additional compensation. However, if the trust document has a more general provision stating that the trustee is entitled to "reasonable" compensation or compensation that is reasonable in the relevant market, then the trustee and beneficiaries have flexibility to raise compensation (or lower it) over time if the alteration is merited. Therefore, a settlor should carefully weigh the benefits and detriments of specific compensation provisions in trust documents.

If the parties desire to change a more structured compensation provision, they may want to file suit to modify a trust. In Texas, on the petition of a trustee or a beneficiary, a court may modify an irrevocable trust and allow a trustee to do things that are not authorized or that are forbidden by the trust document 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 the administrative, nondispositive terms of the trust is necessary or appropriate to prevent waste or avoid impairment of the trust's administration; or (4) the order is necessary or appropriate to achieve the settlor's tax objectives and is not contrary to the settlor's intentions. Tex. Prop. Code § 112.054. The first three grounds do not require the agreement of all interested parties, whereas the fourth ground does require that all beneficiaries agree. Additionally, if all beneficiaries consent, a court may enter an order that is not inconsistent with a material purpose of the trust. *Id*. So, if all beneficiaries agree, it should be relatively easy to modify a trust document to insert appropriate language concerning trustee compensation.

Further, in 2017, the Texas Trust Code was amended to provide that on the petition of a trustee or a beneficiary, a court may order that the terms of the trust be reformed if: (1) reformation of administrative, nondispositive terms of the trust is necessary or appropriate to prevent waste or impairment of the trust's administration; (2) reformation is necessary or appropriate to achieve the settlor's tax objectives or to qualify a distributee for governmental benefits and is not contrary to the settlor's intentions; or (3) reformation is necessary to correct a scrivener's error in the governing document, even if unambiguous, to conform the terms to the settlor's intent. Tex. Prop. Code § 112.054(b). Subsections (e) and (f) also provide: "(e) An order described by Subsection (b-1)(3) may be issued only if the settlor's intent is established by clear and convincing evidence." "(f) Subsection (b-1) is not intended to state the exclusive basis for reformation of trusts, and the bases for reformation of trusts in equity or common law are not affected by this section." *Id*. Importantly, a court may make a reformation retroactive, so as to cure any previous technical violation of the previous wording of the trust document. *Id*.

3. Statutory Basis For Trustee Compensation

When a trust document is silent as to compensation for trustees, the statutory compensation scheme afforded by section 114.061 of the Texas Property Code applies. Tex. Prop. Code § 114.061(a); *see also Bigbee v. Castleberry*, 2008 Tex. App. LEXIS 364, 2008 WL 152382 at *2 n. 1 (Tex. App.—Corpus Christi 2008, no pet.)*;* *Nacol v. McNutt*, 797 S.W.2d 153, 155 (Tex. App.—Houston [14th Dist.] 1990, writ denied) ("[A] trustee is, after all, presumptively entitled to reasonable compensation for her services."). Unless the trust does not allow compensation or only limited compensation, a trustee's payment of reasonable compensation to itself is not a breach of fiduciary duty. Tex. Prop. Code § 114.061; *InterFirst Bank Dallas, N.A. v. Risser*, 739 S.W.2d 882 (Tex. App.—Texarkana 1987, no writ).

Section 114.061 provides, in pertinent part:

> (a) Unless the terms of the trust provide otherwise and except as provided in Subsection (b) of this section, the trustee is entitled to reasonable compensation from the trust for acting as trustee. (b) If the trustee commits a breach of trust, the court may in its discretion deny him all or part of his compensation.

Tex. Prop. Code § 114.061(a). *See also* Uniform Trust Code § 708(a) (providing for reasonable compensation). The statute does not define the term "reasonable compensation."

4. Determining "Reasonable Compensation" In Texas

There is very little common-law authority that assists in determining "reasonable compensation" for a trustee. The main case in Texas on trustee compensation provides that the amount of compensation that a trustee is permitted to charge must be reasonable, having regard to the trustee's responsibility and the care and labor bestowed. *Beaty v. Bales*, 677 S.W.2d 750 (Tex. App.—San Antonio 1984, writ refused n.r.e.). In discussing a trustee's compensation, the *Beaty* court stated:

> Article 7425b-4(K) defines a trustee's compensation as the normal, recurring fee of the trustee for services in the management and administration of the trust estate, irrespective of the manner of compensation of such fee. A trustee's commission is defined as the fee of the trustee for services rendered, other than the normal management and administration of the trust estate. The pay customarily given other agents or servants for similar work is one of the factors considered in determining reasonable compensation for trustees. BOGERT, LAW OF TRUSTS 369 (4th ed. 1963). In this case five witnesses testified as to customary compensation paid by area ranchers to ranch managers. The jury found that the compensation paid to the trustee was reasonable.

Id.

Texas courts have generally affirmed fact finders' determinations as to whether compensation was reasonable. In *Combs*, a court of appeals affirmed a jury's finding that a trustee did not over compensate himself and breach fiduciary duties. *Combs v. Gent*, 181 S.W.3d 378, 385 (Tex. App.—Dallas 2005, no pet.). Based on the facts, the court held that the jury's determination was within their discretion:

> After reviewing the record, we cannot conclude that the jury's failure to find a breach of fiduciary duty was so against the great weight and preponderance of the evidence as to be manifestly unjust. Gent charged a total of $ 61,820.28 for his services as trustee and lawyer for two years. From the outset, Vencill told Gent there would be "one bloodshed war" after her death, and four other lawyers declined to take the job before Gent accepted it. Gent and Vencill discussed his fee, and Vencill "perfectly understood" their arrangement.

Id. *See also Estate of Townes v. Townes*, 867 S.W.2d 414, 418 (Tex. App.—Houston [14th Dist.] 1993, writ denied) (affirming finding that a defendant breached fiduciary duty based in part on expert testimony that his withdrawals for compensation were excessive).

There is more authority in other jurisdictions regarding "reasonable compensation" determinations. In fact, some jurisdictions have statutes that provide factors to weigh in determining whether compensation is reasonable:

> The custom of the community; the trustee's skill, experience, and facilities; the time devoted to trust duties; the amount and character of the trust property; the degree of

> difficulty, responsibility and risk assumed in administering the trust, including in making discretionary distributions; the nature and costs of services rendered by others; and the quality of the trustee's performance.

Bogert, TRUSTS AND ESTATES, § 975.

Under a reasonable-compensation statute, the amount of compensation to be awarded to a trustee rests within the "sound discretion" of the trial court, subject to appellate review for "abuse" of that discretion; but compensation for a trustee's services should only be for services performed in the administration of the trust and in the management and protection of the trust estate. *Lampe v. Pawlarczyk*, 731 N.E.2d 867 (Ill. App. 2000). *See In re Butler's Trusts*, 223 Minn. 196, 26 N.W.2d 204, 211 (Minn. 1947) (usual and normal services performed by trustee in return for compensation are "all services involved in the exercise of his discretionary powers or duties in managing the trust and, in addition, certain ministerial duties" such as "keeping accurate and complete bookkeeping records and … preparing periodic administration accounts"); G. Gleason Bogert & G. Taylor Bogert, TRUSTS & TRUSTEES § 980, at 189 (revised 2d ed. 1983) (compensation of trustee is paid for administration of the trust).

Regarding reasonable compensation, the Restatement provides:

> (1) A trustee is entitled to reasonable compensation out of the trust estate for services as trustee, unless the terms of the trust provide otherwise or the trustee agrees to forgo compensation.
>
> ….
>
> Some state statutes still prescribe formulas for determining the amount of a trustee's compensation. They usually provide that trustees' fees are to be based on specified percentages of the principal or of the income and principal of the trust. Normally, the statute in effect at the time the compensation is claimed controls, regardless of when the trust was created. If the trustee has negligible active duties, statutes fixing compensation for trustees are usually held not to apply. Furthermore, statutes are normally to be interpreted as allowing the court to authorize additional or reduced compensation if the court determines that the statutory formula would result in a trustee's fee that is unreasonably high or low.
>
> Many statutes merely provide that trustees are entitled to reasonable compensation. The reasonable compensation rule applies where there is no statute dealing with trustee compensation.
>
> ….
>
> Trial courts have discretion in determining reasonable compensation, but their determinations are subject to review for abuse of discretion.

Local custom is a factor to be considered in determining compensation. Other relevant factors are: the trustee's skill, experience and facilities, and the time devoted to trust duties; the amount and character of the trust property; the degree of difficulty, responsibility, and risk assumed in administering the trust, including in making discretionary distributions; the nature and costs of services rendered by others; and the quality of the trustee's performance.

The amount of compensation received by a trustee is relevant in determining whether certain costs of others' services are reimbursable under Subsection (2). This is particularly so of costs of hiring advisors, agents, and others to render services expected or normally to be performed by the trustee. Conversely, even proper expenses of this type may affect what is reasonable compensation for the trustee… Absent a statute so requiring, the trustee's compensation need not be approved by a court, but a trustee who has taken excessive compensation may be ordered to refund it. To make the possibility of judicial review meaningful, beneficiaries should be informed of compensation being taken by the trustee.

RESTATEMENT (THIRD) OF TRUSTS, § 38.

One commentator provides:

> When determining a reasonable fee for a trustee, the courts look to the following factors: (1) The degree of responsibility required by law; (2) The degree of responsibility that a trustee has under the terms of the trust instrument; (3) The success or failure of the trustee's administration; (4) The trustee's fidelity or disloyalty; (5) The unusual skill or experience of the trustee; (6) The amount of risk and responsibility assumed; (7) The time consumed; (8) The custom in the community; (9) The character of the services rendered whether routine or otherwise; (10) The trustee's estimate, if any, of the value of his or her services.
>
> There are several advantages to providing fees for trustees on the basis of reasonableness rather than according to a set fee schedule. A fee schedule can be unfair if general investment conditions change, or if the duties expected of trustees in a particular situation differ from the norm. Trustees are more inclined to use their best efforts if they know they will receive a fee commensurate with those efforts.

> In determining a reasonable fee for ordinary services rendered by a testamentary trustee, courts through the years have used different formulas as informal guides. Many years ago it was common to determine the amount of the annual fee for the trustee by taking a percentage of the gross income received; the fees were often computed at between five percent and seven and one-half percent of the gross income. At that time the prudent investor was primarily seeking the production of income and secondarily protecting his or her capital. However, the modern prudent investor is concerned not only with receiving income, but with capital appreciation. Hence, the usual method today of determining a reasonable fee for ordinary services is to take a percentage of the total value of the principal of the trust estate.

1 Texas Estate Planning, § 35.51 (citing Nossaman & Wyatt, TRUST ADMINISTRATION AND TAXATION, VOL. 1A, CH. 32, TRUSTEE'S RIGHTS AND LIABILITIES).

Another commentator states that the method of compensation has changed over time:

> In determining a reasonable fee for ordinary services rendered by a testamentary trustee, courts through the years have used different formulae as informal guides. Many years ago it was common to determine the amount of the annual fee for the trustee by taking a percentage of the gross income received; the fees were often computed at between five percent and seven and one-half percent of the gross income. At that time the prudent investor was primarily seeking the production of income and secondarily protecting his or her capital. However, the modern prudent investor is concerned, not only with receiving income, but with capital appreciation. Hence, the usual method today of determining a reasonable fee for ordinary services is to take a percentage of the total value of the principal of the trust estate.

9 Texas Transaction Guide—Legal Forms § 50C.26. Furthermore, having a flexible approach to trustee compensation is preferable because a rigid schedule approach can be unfair if general investment conditions change or the normal duties of the trustee change, and trustees will be more inclined to use their best efforts if they know that they will receive fair compensation. *Id.* Moreover, a flexible approach can allow compensation to be decreased where the circumstances justify such an action whereas a rigid schedule may not allow for same. *Id.*

Corporate trustees often charge the following types of fees: a percentage of assets held in the trust on an annual basis; a percentage of income collected from specialty assets (such as real estate, oil and gas, notes/mortgages, closely held businesses); termination fees; and a catch-all for extraordinary services (potentially on an hourly basis). A trustee may charge multiple different types of fees, so long as the total fee is reasonable.

For example, in *In Matter of Trusts Under Will of Dwan*, a two-percent termination fee (amounting to $53,456, in addition to annual fees over an 18-year period, totaling $66,981) was affirmed under a "reasonable compensation" statute for a trust with an ending corpus of over $2,500,000. 371 N.W.2d 641 (Minn. Ct. App. 1985). The court said that "most trust institutions in the area charged a 2 percent deferred charge after 5-10 years of trust administration, as well as an annual fee." *Id*. at 643. It should be noted that a dissenting judge opined "that the trial court abdicated its fact finding function to a panel of industry experts and ought to have considered factors such as time and labor, the complexity and novelty of [the] problems involved, the extent of the responsibilities assumed, and the results obtained . . . . These trusts were as easy to administer as can be imagined." *Id*. at 644. *See also* J. Sklarz & R. Whitman, "*Are Percentage Trust Termination Fees Appropriate?*," 15 Probate & Property 49 (Nov./Dec. 2001) (suggesting that corporate fiduciaries should consider abandoning the practice of attempting to charge percentage termination fees, and observing: "If a court challenge is brought, any percentage termination fee may be viewed as suspect. Charging a reasonable hourly fee for work performed should markedly reduce beneficiary dissatisfaction and court challenges.").

Certainly, evidence of reasonableness may require evidence regarding what similar trustees charge for similar services in the relevant market. For example, in *Gregory v. First National Bank & Trust Co.*, a beneficiary complained that a fee was "based solely on the value of the securities [in the trust] without regard to the services rendered," but the fee was upheld on the basis of testimony that it was both "customary and reasonable." 84 Ill.App.3d 957, 40 Ill.Dec. 577, 406 N.E.2d 583 (1980). *See also Estate of Taylor*, 6 Cal.App.3d 16, 85 Cal.Rptr. 474 (1970) (allowing a bank co-trustee a fee of 3/4 of 1% of the value of the trust corpus because "this rate generally prevailed among banks in the Los Angeles area"); *Mercer v. Merchants National Bank*, 112 N.H. 441, 298 A.2d 736 (1972) (approving 2-1/2% termination fee as being customary).

One commentator has discussed corporate trustees' fee schedules:

> Many corporate trustees in the United States publish schedules of fees for their services as trustee under a will or trust agreement. The trustee's schedule in effect at the time the instrument becomes effective (and as the schedule may thereafter be amended from time to time) is expected to be applied by the corporate trustee, unless modified by prior agreement or by some other compensation provision in the trust instrument, and to be approved by the court as "reasonable" under the applicable statute, or to be within the then current statutory schedule of fees. Special rates are sometimes quoted for inactive trusts, such as a title-holding land trust or a life insurance trust during the life of the insured. Some corporate trustees avoid fixed fee arrangements and insist that the trust instruments include a clause

> granting them "reasonable" compensation or specifying other guidelines that can be modified to meet changing conditions.

Bogert, TRUSTS AND ESTATES, § 976.

Courts have frequently ordered trustees to refund excessive compensation they have taken. *See, e.g., In re Estate of Deibig*, 49 Wis.2d 237, 181 N.W.2d 413 (1970); *Vogt v. Seattle-First National Bank,* 117 Wash. 2d 541, 817 P.2d 1364 (1991); *Marks v. Marks*, 51 Haw. 548, 465 P.2d 996 (1970); and *Fred Hutchinson Cancer Research Center v. Holman*, 107 Wash.2d 693, 732 P.2d 974 (1987).

5. Apportionment of Compensation Between Income and Principal

The payment of trust expenses as between principal and income can be a very important issue. Often there are beneficiaries that are entitled to distributions solely from income of the trust. If a trustee's compensation is solely paid from income, it may result in potentially unfair treatment as between the income beneficiaries and remainder beneficiaries. Certainly, a trustee should follow the trust document if it describes a method for the payment of trustee compensation from income, principal, or both. Tex. Prop. Code § 116.004(a)(1).

In the absence of a provision in a trust document, the Texas Property Code has a default provision for the allocation of trustee's compensation. Section 116.201 provides:

> A trustee shall make the following disbursements from income to the extent that they are not disbursements to which Section 116.051(2)(B) or (C) applies:
>
> (1) one-half of the regular compensation of the trustee and of any person providing investment advisory or custodial services to the trustee unless, consistent with the trustee's fiduciary duties, the trustee determines that a different portion, none, or all of the compensation should be allocated to income…

Tex. Prop. Code § 116.201.

Further, Section 116.202 provides:

> (a) A trustee shall make the following disbursements from principal:
>
> (1) the remaining one-half of the disbursements described in Section 116.201(1) unless, consistent with the trustee's fiduciary duties, the trustee determines that a different portion, none, or all of those disbursements should be allocated to income, in which case that portion of the disbursements that are not allocated to income shall be allocated to principal;
>
> (1-a) the remaining one-half of the disbursements described in Section 116.201(2);
>
> (2) all of the trustee's compensation calculated on principal as a fee for

> acceptance, distribution, or termination, and disbursements made to prepare property for sale…

Tex. Prop. Code § 116.201.

Regarding the allocation of trustee compensation as between income and principal, one commentator provides:

> The Uniform Principal and Income Act establishes rules for allocating various disbursements between principal and income. The trustee's compensation, fees for investment advisors or custodial services, and expenses for accountings, judicial proceedings, or other matters involving both income and remainder interests are divided evenly between principal and income, unless otherwise ordered by the court…
>
> The will may vary the statutory rules for charging the trustee's compensation, attorney's fees, and court costs to principal or income … The trustee's regular compensation and the attorney's fees and court costs incurred on periodic accountings to the court are among the largest items of expense incurred on a regular basis by typical testamentary trusts. If no special provision is made in the will, these items will be charged equally to principal and income. Such an allocation may or may not fit the plan of a particular testator. A testator who is concerned with the maximization of income may wish, for example, that such items be charged entirely to principal. A testator who is more concerned with the preservation of principal may wish that they be charged to income, so that they will not erode the trust principal.

9 Texas Transaction Guide—Legal Forms, § 50B.210.

6. <u>Compensation for Co-Trustees</u>

Where there are multiple trustees, the combined compensation must be reasonable. In this regard, the Restatement provides:

> When there are two or more co-trustees, compensation that is fixed by statute or trust provision ordinarily is to be divided among them in accordance with the relative value of their services. Where the rule of reasonable compensation applies, see generally Comment c, and especially Comment c(1).
>
> In the aggregate, the reasonable fees for multiple trustees may be higher than for a single trustee, because the normal duty of each trustee to participate in all aspects of administration (see § 81, and cf. § 80) can be expected not only to result in some duplication of effort but also to contribute to the quality of administration. And see Comment c(1) on

> factors (time, skill, etc.) relevant to establishing the compensation of each of the co-trustees.

RESTATEMENT (THIRD) OF TRUSTS, § 38.

One commentator states:

> In the absence of statute that specifically addresses the method of apportionment, two or more trustees of the same trust are compensated according to the amount of services each has rendered, the whole sum paid the group usually amounting to what would have been paid a single trustee for like work. The single commission is not divided among them in proportion to the number of trustees, but on a quantum meruit basis.

Bogert, TRUSTS AND ESTATES, § 978

The Texas Banker's Association ("TBA") has form policies for bank trust departments. The TBA's policy for dividing compensation with a co-fiduciary states: "Except under unusual circumstances, it is the policy of the trust department to request the same allowance or make the same charge for serving as co-fiduciary as for sole fiduciary. This policy is based on experiences with co-fiduciary appointments which have revealed that work and responsibility do not diminish with the addition of a co-fiduciary." TBA Policies, New Business, Section C, Policy No. 10. So, the TBA takes the reasonable position that where a co-trustee does the work of a sole trustee, it should be compensated as such.

In the context of co-trustees, there is normally one trustee that does the majority of the work administering the trust (managing financial investments; managing real estate, oil and gas, closely held business and other investments, retaining vendors, attorneys, accountants; paying expenses; paying taxes; determining distributions; etc.). That trustee should be paid more than another co-trustee that simply monitors the activities and participates in big-picture and distribution decisions. The co-trustees should discuss what fair total compensation is for the services that they both provide. Finally, it is not unfair for co-trustee compensation to be higher than sole-trustee compensation, and a settlor should be aware of that when he or she executes a trust document providing for that number of trust administrators.

7. <u>Attorney's Fees Comparisons</u>

In Texas, unlike trustee compensation, there is an abundance of authority for how to properly calculate reasonable attorney's fees. The Texas Supreme Court listed the following factors in determining whether attorney's fees were reasonable:

> (1) the time and labor required, the novelty and difficulty of the questions involved, and the skill required to perform the legal service properly;
>
> (2) the likelihood . . . that the acceptance of the particular employment will preclude other employment by the lawyer;
>
> (3) the fee customarily charged in the locality for similar legal services;

> (4) the amount involved and the results obtained;
>
> (5) the time limitations imposed by the client or the circumstances;
>
> (6) the nature and length of the professional relationship with the client;
>
> (7) the experience, reputation and ability of the lawyer or lawyers performing the services; and
>
> (8) whether the fee is fixed or contingent on results obtained or uncertainty of collection before the legal services have been rendered

Arthur Andersen & Co. v. Perry Equip. Corp., 945 S.W.2d 812, 818 (Tex. 1997).

Courts tend to focus on whether the rate is reasonable and the number of hours expended. *City of Laredo v. Montano*, 414 S.W.3d 731, 736 (Tex. 2013) (per curiam). The Texas Supreme Court has held that the lodestar method has an expansive application to be used when evidence of reasonable hours worked multiplied by reasonable hourly rates can provide an objective analytical framework that is presumptively reasonable. *See Montano*, 414 S.W.3d at 736. Most recently, the Court affirmed the use of the lodestar method for all attorney's fees awards in *Rohrmoos Venture v. UTSW DVA Healthcare, LLP*, no. 16-0006, 2019 Tex. LEXIS 389 (Tex. April 26, 2019).

Though this attorney's fees analysis may be helpful to trustee compensation, courts in other jurisdictions have not allowed a time-based formula as used in attorney's fees cases as a direct substitute for determining a reasonable trustee's fee. *See, e.g., In re Judicial Settlement of the Final Account of Proceedings of Panzierer*, 2019 N.Y. Misc. LEXIS 4512 (S.C. N.Y. August 15, 2019); *Robert Rauschenberg Found. v. Grutman*, 198 So. 3d 685 (Fla. 2016); *Ruttenberg v. Friedman*, 97 So. 3d 114 (Ala. 2012); *Hayward v. Plant*, 98 Conn. 374, 119 A. 341 (1923). For example, in *In re Judicial Settlement of the Final Account of Proceedings of Panzierer*, the court held that a time-based approach was not appropriate for determining an executor's fee and used a multi-factor approach. 2019 N.Y. Misc. LEXIS 4512 (S.C. N.Y. August 15, 2019). The court stated:

> As pertinent to evaluating the services of an individual fiduciary, in all of these cases, the courts' multi-factor approach recognized, in no particular order, the following factors: 1) the expertise, knowledge and reputation of the service provider, 2) the difficulty of the issues involved and the skills required to handle them, 3) the size of the estate or trust being administered, 4) the time and labor involved, 4) the responsibilities undertaken and the risks assumed, 5) the benefits and results achieved for the estate or trust, and 6) the customary fee charged for similar services.

Id.

In *In Re Estate of Rauschenberg*, trustees sought $60 million in trustee fees due to their work in increasing the trust's assets from $605 million to over $2 billion. Circuit

Court of Florida, 20th Judicial Circuit (Lee County), File No. 08-CP-2479 (Aug. 15, 2014). The beneficiary (a foundation) asserted that a lodestar method would only allow them a total of $375,000 in compensation. The trial court awarded $24,600,000 to the trustees, rejected the use of the lodestar method, and instead used a multi-factor evaluation. The court looked to the criteria set forth in *West Coast Hospital Ass'n v. Florida Nat'l Bank of Jacksonville*, 100 So. 2d 807 (Fla. 1958):

> 1. The amount of capital and income received and disbursed by the trustee; 2. The wages or salary customarily granted to agents or servants for performing like work in the community; 3. The success or failure of the administration of the trustee; 4. Any unusual skill or experience which the trustee in question may have brought to his work; 5. The fidelity or disloyalty displayed by the trustee; 6. The amount of risk and responsibility assumed; 7. The time consumed in carrying out the trust; 8. The custom in the community as to allowances to trustees by settlors or courts and as to charges exacted by trust companies and banks; 9. The character of the work done in the course of administration, whether routine or involving skill and judgment; 10. Any estimate which the trustee has given of the value of his own services; and 11. Payments made by the cestuis to the trustee and intended to be applied toward his compensation.

Id. After hearing from 21 witnesses and seeing over 300 exhibits, the trial court found "that there is no precedent for use of the lodestar analysis to determine a reasonable fee for trustees, and further [found] that the use of the lodestar analysis would be unreasonable under the particular facts and circumstances of this case." *Id.* The case was affirmed on appeal. *Robert Rauschenberg Found. v Grutman*, 198 So 3d 685 (Fla. 2016) ("[T]he trial court correctly refused to calculate the Trustees' fees using the lodestar method. The court properly applied the West Coast factors, and the court's findings regarding those factors and the reasonable fee amount are supported by the evidence presented at trial.").

Accordingly, it is undecided in Texas whether a court should use a lodestar method (time and rate) analysis for determining reasonable trustee's compensation, but authority from other jurisdictions would not support such an approach. Certainly, the factors used by the Texas Supreme Court to determine a reasonable attorney's fee award may be helpful in analyzing trustee compensation, but that approach is not a direct substitute for determining trustee compensation.

8. <u>Extra Compensation For Other Services</u>

A trustee's reasonable compensation should be paid for normal trust administration services. However, a trustee may seek additional compensation (in addition to reasonable trustee compensation for administration services) for providing other types of services to the trust.

It should be noted that a trustee may violate a duty of loyalty by hiring itself to do other non-administrative work, such as legal work. That may set up a conflict-of-interest situation. M. Heckscher, "*The Special Problems Which Arise When an Attorney Serves as Fiduciary*," 17 ACTEC Notes 137, 138 (1991).

The Restatement provides:

> Except as stated in Comments c-c(3) or in Comments c(4)-c(6) or c(8), the duty of loyalty prohibits a trustee from engaging on behalf of the trust in transactions with the trustee personally.… *Also, except as described in c(5), a trustee, acting in a fiduciary capacity, cannot properly hire the trustee personally to perform services for the trust*.

RESTATEMENT (THIRD) OF TRUSTS, § 78(d).

Another commentator states:

> The danger is that if [a trustee] is entitled to compensation, he will be tempted to create a job for himself in order to secure the compensation [or] . . . to employ himself even if another person might render better service. The question is whether there is sufficient protection to the estate in [the fact] that the court will not award the trustee extra compensation unless it believes that he really deserves it. . . . By the weight of authority in the United States . . . the trustee is entitled to extra compensation for extra services, subject to the safeguard that the compensation is given only to the extent that the court may award it.

IIIA William F. Fratcher, SCOTT ON TRUSTS § 242.2 (4th ed. 1988).

However, the Restatement also provides:

> Although under Subsection (2) self-hiring by a trustee is generally prohibited as a form of self-dealing (see Comment d), in some circumstances a trustee may provide to the trust, and receive additional compensation for, special services that—while not required of trustees generally—are necessary or appropriate to prudent administration of the trust. It is reasonable to expect that a trustee who possesses special skills and facilities that are useful in trust administration will use those skills and facilities in administering the trust, and also to expect that the trustee's familiarity with the purposes and affairs of the trust will result in efficiency and cost advantages to the trust. Cf. Comment c(2). Also cf. § 77(3) and § 77, Comment e, on the duty of trustees to make use of their special skills and facilities, and § 88 on the duty of trustees to be cost-conscious in trust administration. See further § 38, Comment c(1), on factors to be considered in

determining trustees' "reasonable compensation," and id., Comment d, indicating that a trustee may receive additional compensation for "special services . . ., for example as attorney or real-estate agent, . . . when it is advantageous to the trust that the trustee rather than another perform those services" (noting that this may be "particularly relevant under a statutory fee schedule").

> Although the duty of loyalty does not strictly prohibit the trustee from providing this type of compensated services for which the trustee has a special competence, the trustee is not relieved of the normal duty to act with prudence and in the interest of the beneficiaries in determining whether the services are reasonably necessary and by whom they may best be provided. Thus, the risks inherent in sacrificing independence and objectivity of judgment in deciding these matters must be justifiable in terms of the expected benefits to the trust through greater efficiency and reduced time and expense in allowing the trustee to render the services. Furthermore, the trustee has a duty to disclose to the beneficiaries the special services performed and the additional time and compensation involved (see § 82, Comment d, and § 83, Comment c). Although the special compensation need not be approved by a court, trustee compensation may be challenged in court, and a trustee who is found to have taken excessive compensation will be ordered to refund it.

RESTATEMENT (THIRD) OF TRUSTS, § 78(c)(6).

Yet, where it is done in good faith and with reasonable compensation, it may be allowed. *Dardovitch v. Haltzman*, 190 F.3d 125, 138 n.10 (3d Cir. 1999) ("A trustee's choice to use his own special [legal] services—beyond those usually rendered by a trustee—where the trust requires them, ordinarily does not violate the prohibition against self-dealing . . . [within limits] of good faith and reasonable care."); *Lembo v. Casaly*, 5 Mass. App. Ct. 240, 361 N.E.2d 1314, 1317 (1977) (finding it proper to allow "extra compensation to a trustee who is also an attorney for his performance of legal services in behalf of a trust which are necessary and not comprehended within the usual duties of a trustee."); RESTATEMENT (THIRD) OF TRUSTS, § 38(d) ("A trustee who renders special services in the administration of the trust, for example as attorney or real-estate agent, may be awarded compensation for such services when it is advantageous to the trust that the trustee rather than another perform those services.").

One commentator has stated:

> A grey area has developed in the law, namely the selling by the trustee of legal, brokerage, and consulting services to the trust. Again, as with the sale of goods, such transactions fall within

the strict definition of self-dealing in that economic benefit is accruing to the trustee from the trust estate over and above the trustee fees. In England the practice is forbidden, but in most American jurisdictions it is not. . . . [The practice] is, nonetheless, troubling. . . . The trustee is on both sides of the service contract. . . . At the very least such transactions put great stress on the trustee's independent judgment. Thus, to avoid even the appearance of impropriety, the trustee should not charge for routine legal or consulting tasks and should turn over to the trust any routine brokerage commissions that are generated. . . . Extraordinary legal, consulting, and brokerage services should be purchased from the trust at arm's length from independent third parties. . . . [T]he beneficiaries are deprived of the benefit of the checks and balances inherent in arm's-length contractual relationships. When the trustee, for example, acts also as attorney, it must fall to the court or to the beneficiaries to monitor the quality of the legal work, the commitment to the expeditious resolution of the legal matter, and the reasonableness of legal fees. Because court oversight is inefficient and beneficiary oversight often illusory, neither alternative is particularly satisfactory.

Charles E. Rounds, Jr., Loring: A TRUSTEE'S HANDBOOK, § 6.1.3.3 (8th ed. 2006). *See also* A. Hook & T. Begley, Jr., *"Should an Elder Law Attorney Serve as a Trustee?,"* 30 ESTATE PLANNING 202, 204-207 (2003) (providing a more favorable perspective on trustee's retaining themselves).

In Texas, extra compensation may be paid to a trustee out of trust funds for special services rendered to the trust outside of the trustee's routine work, where the services are of such a nature that they are properly chargeable as current expenses of the estate and that the trustee could have employed another to perform them. *Slay v. Burnett Trust*, 143 Tex. 621, 187 S.W.2d 377 (1945). Thus, although a trustee is ordinarily not allowed to make any profit out of the trust beyond the compensation provided by the settlor, a trustee who is an attorney and who accepts employment from the co-trustees in that capacity is entitled to attorney's fees out of the trust fund. *West Texas Bank & Trust Co. v. Matlock*, 212 S.W. 937 (Tex. Comm'n App. 1919). Additionally, a person who acts both as executor and trustee of an estate may be compensated in both capacities if the trust instrument so provides. *Nations v. Ulmer*, 139 S.W.2d 352 (Tex. Civ. App.—El Paso 1940, writ dismissed).

Ultimately, trustees may be entitled to extra compensation for extra work in Texas, but this self-interested transaction will likely be judged with a presumption of unfairness such that the trustee will have the burden to prove the fairness of the compensation if it is ever challenged in court.

For example, a trust may own a business. The trustee has the option to hire and compensate independent managers for the business. The trustee may also decide to do the work of managing the day-to-day operations of the business itself. Is the trustee entitled to additional compensation for that additional work? Yes. But the issue is how much more compensation. Is the trustee really the best person for the job (qualified)? Has the trustee done a study to determine what similar managers earn in similar businesses? Ultimately, if challenged, the trustee will be in the position of having to justify the reasonableness of any additional compensation paid to itself. If it fails to do so, then it breaches its fiduciary duty in overcompensating itself.

9. Right To Other Benefits Due To Trustee Position

Through process of administering a trust, a trustee may have the opportunity to obtain other benefits, aside from direct compensation. For example, a corporate trustee may deposit trust funds in its own retail side of the bank and be able to use those funds to make loans and earn compensation. A corporate trustee may invest trust funds in its own proprietary mutual funds and earn fees and revenues from the funds.

Once again, a duty of loyalty does not allow a trustee to benefit from its fiduciary relationship other than from direct compensation. *Slay v. Burnett Trust*, 187 S.W.2d 377 (Tex. 1945). *See also Humane Soc'y of Austin & Travis County v. Austin Nat'l Bank*, 531 S.W.2d 574, 577 (Tex. 1975) (trustee cannot profit from trust relationship); *Lesikar v. Rappeport*, 33 S.W.3d 282, 297 (Tex. App.—Texarkana 2000, pet. denied) (same); *Furr v. Hall*, 553 S.W.2d 666 (Tex. Civ. App.—Amarillo 1977, writ ref'd n.r.e.) (executors prohibited from placing themselves in any position where self-interest would or may have conflicted with their obligations as trustees even though they may have acted in good faith and the beneficiary suffered no damage); *Daniel v. Henderson*, 183 S.W.2d 242, (Tex. Civ. App.—El Paso 1944, no writ) (trustee violates his duty if he sells trust property to a firm of which he is a member or to a corporation in which he has a controlling or substantial interest).

The Restatement (Third) of Trusts specifically discusses a trustee obtaining benefits from third parties in the administration of a trust:

> d(1). Outside compensation for acts performed as trustee. *A trustee engages in self-dealing and therefore normally violates the duty of loyalty by personally accepting from a third person any fee, commission, or other compensation for an act done by the trustee in connection with the administration of the trust. But see* Comment c(8) on proprietary funds, and cf. Comment c(5) on self-employment.
>
> Accordingly, if the trustee sells trust property and accepts (and retains) a bonus from the purchaser for making the sale, the trustee commits a breach of trust. So also, if the trustee is employed by an insurance company with which the trustee insures trust property and from which the trustee receives a commission for placing the insurance, the trustee is at least accountable to the trust for the commission (cf. Comment c(5)). The same rule applies

> if a trustee's fiduciary dealings with a third party are subsequently "rewarded" (even by more-than-trivial expression of appreciation) by the third party, and therefore the reward must be accounted for to the trust; even an informal prearrangement, practice, or expectation that the trustee would be so rewarded could render the dealings a breach of trust.
>
> *If a trustee were allowed to keep any form of compensation from a third person for acts performed in the administration of the trust, a temptation would exist that would deprive the beneficiaries of the circumstantial assurance of independent and objective fiduciary judgment that the trust law seeks to provide* (*see* Comment b).
>
> ….
>
> For purposes of this Comment (and Comment d more generally), a trustee's action or decision that is motivated by and taken in the best interest of the beneficiaries does not violate the rule of Subsection (1) or (2) merely because there may be an incidental benefit to the trustee.

RESTATEMENT (THIRD) OF TRUSTS, § 78(d)(1) (emphasis added). *See also Fulton Nat'l Bank v. Tate,* 363 F.2d 562, 570 (5th Cir. 1966); *Perez v. Chimes Dist. of Columbia, Inc.*, No.: RDB-15-3315, 2016 U.S. Dist. LEXIS 126982 (D. Md., Sept. 19, 2016); *In re Estate of Campbell*, 36 Haw. 631, 1944 Haw. LEXIS 21 (Haw. S. Ct. 1944); *Reichert's Estate*, 1946 Pa. Dist. & Cnty. Dec. LEXIS 31 (Com. Pl. Ct. Pa. Apr 12, 1946).

Another commentator has explained the dichotomy between a trustee being allowed compensation from the trust (even extra compensation for added service) and being allowed compensation from third parties:

> The American rule allowing trustee compensation has been extended beyond core trustee functions to a variety of settings in which the trustee is allowed to obtain extra compensation for nontraditional services, for example, when the trustee also serves as an executor, lawyer, real estate agent, or insurance agent. This application of the American rule is in some tension with the basic anti-kickback rule, which also derives from the duty of loyalty. The Restatement (Second) version provides: "The trustee violates his duty to the beneficiary if he accepts for himself from a third person any bonus or commission for any act done by him in connection with the administration of the trust." Thus, a trustee who is also an insurance agent and receives from the insurer "a commission for placing the insurance … is accountable

for the commission." Were the agent allowed to keep it, "he would be tempted to place the insurance with the company which employs him, even though that might not be for the best interest of the beneficiary."

When, however, the trust itself, as opposed to an outside transactional party, pays the trustee a commission or other extra compensation, American law mostly reverses course and allows the trustee to collect. "[A] trustee who renders professional or other services not usually rendered by trustees in the administration of the trust, as for example services as attorney or as real estate agent, may be awarded extra compensation for such services." Because, however, the trustee's temptation to hire himself or herself, "even though that might be for the best interest of the beneficiary," is no different depending on whether the commission is paid by the trust or by a third party, the question arises of why the two situations are treated oppositely. The longstanding concern about concealment of improper payments, discussed above, may motivate some suspicion of commissions paid by third parties, who do not operate under fiduciary duties of recordkeeping and disclosure. Likewise, under the rule allowing the trustee extra compensation from the trust for extra services, the trustee operates under the fiduciary duty of reasonableness in claiming or setting such extra compensation, in contrast to a third-party transactional payor who is not a fiduciary for the trust.

The tenuousness of these distinctions may provide grounds for questioning some applications of the ban on payments from third parties, but the rule allowing extra compensation for trustee-provided professional services rests on a firm footing, resembling strongly the rationale for allowing an institutional trustee to supply its own compensated financial services: Integration promotes economies of scale and other synergies. The sheer informational advantage possessed by a trustee or executor who has already mastered the affairs of the trust or estate for purposes of routine administration often makes that person better suited than a newcomer to provide legal, accounting, real estate brokerage, or other needed services.

Bogert's treatise is hostile to the rule allowing the trustee to receive extra compensation, fearing that the trustee "may be tempted to employ himself for special

> duties when there is no real need and to exaggerate the value of the work he performs." Bogert would prefer to treat such payments as violations of the sole interest rule, hence voidable at the option of the trust beneficiary. But Bogert leaves unmentioned the argument from mutual advantage that has prevailed in these cases, that the benefits of allowing the trustee to be the service provider outweigh the dangers. Scott's treatise, on the other hand, has been more sensitive to the rationale for the exception.

J. Langbein, Questioning the Trust Law Duty of Loyalty: Sole Interest or Best Interest?, 114 YALE L.J. 929, 978 (2005).

For example, in *Perez v. Chimes Dist. of Columbia, Inc.*, the court held that a plaintiff stated a claim for breach of fiduciary duty arising from an ERISA plan administrator retaining commissions from service providers:

> In Count IV of the First Amended Complaint, the Secretary alleges that FCE breached its fiduciary duties of loyalty and prudence, in violation of 29 U.S.C. §§ 1104(a)(1)(A)-(B), and engaged in prohibited self-dealing with Plan assets, in violation of 29 U.S.C. § 1106(b)(1), by "retain[ing] payments from Plan service providers and fail[ing] to forward them to the Plan as required by Chimes DC, and receiv[ing] compensation in relation to FCE's management of Plan assets that was not disclosed to Chimes." Count II further alleges that FCE "received consideration for its own personal accounts" from these transactions, in violation of 29 U.S.C. § 1106(b)(3). Like in Counts I and II, Count IV also alleges that Beckman and Porter are liable for these violations because they "knowingly participated in the violations of FCE with respect to the payments received in connection with Plan asset transactions," pursuant to 29 U.S.C. § 1132(a)(5).
>
> In support of their Motion to Dismiss, the FCE Defendants argue that "Count IV fails because FCE is contractually entitled to receive payments from other service providers and did not control plan assets." They contend that FCE could not have breached any of its obligations under ERISA by receiving payments from service providers because "[t]he Fee Schedule incorporated by reference in the Complaint expressly provides that FCE may receive payments and commissions from the Plan's insurers and other service providers." Additionally, they argue that Count IV must fail "because the third party payments to FCE were not Plan assets," but "were made by the Plan's third party

service providers to FCE in accordance with the Fee Disclosure statement."

In this case, the Secretary alleges that "[i]n connection with the Plan's contracts with the service providers, the FCE Defendants caused FCE to receive rebates, commissions, and other payments from the service providers." Additionally, the Secretary alleges that "FCE exercised its fiduciary authority and control over the Plan's contracts with other service providers to increase its compensation through undisclosed commissions, fees and other payments." The Secretary further alleges that "Chimes DC and FCE had agreed that, with a few specific exceptions, any commissions or rebates paid by the Plan service providers to FCE should be forwarded to the Plan," but "[c]ontrary to this agreement," "FCE failed to forward all payments that it received from service providers to the Plan," "caus[ing] losses to the Plan." *Id.* at ¶ 47-48, 53. "Congress intended ERISA's fiduciary responsibility provisions to codify the common law of trusts." *Griggs v. E.I. DuPont de Nemours & Co.*, 237 F.3d 371, 380 (4th Cir. 2001) (citing *Firestone Tire & Rubber Co. v. Bruch*, 489 U.S. 101, 110, 109 S. Ct. 948, 103 L. Ed. 2d 80 (1989)). The duty of loyalty under trust law includes a "strict prohibition against self-dealing." *French v. Wachovia Bank, N.A.*, 722 F.3d 1079, 1085 (7th Cir. 2013). This prohibition applies whether or not the self-dealing results in profits drawn from the trust itself or paid by a third party. *Id.* (citing Restatement (Third) of Trusts § 78 cmt. d(1) ("A trustee engages in self-dealing and therefore normally violates the duty of loyalty by personally accepting from a third person any . . . compensation for an act done by the trustee in connection with the administration of the trust.")).

With respect to the "plan assets" at issue, the Secretary has clarified that the "'plan assets'" at issue in this case are not the compensation FCE received from third parties but rather FCE's use of payments from the Plan, which it negotiated, to third parties as a means by which FCE was able to obtain commissions and other payments from third parties." Secretary's Opp'n, p. 52, ECF No. 83. The FCE Defendants have cited no case authority rejecting this theory under the facts alleged here. For these reasons, the FCE Defendants' arguments fail with respect to Count IV.

2016 U.S. Dist. LEXIS 126982, *30-36.

Further, in *French v. Wachovia Bank, N.A.*, a plaintiff sued a bank for self-dealing by entering into an insurance transaction where the bank's affiliate would earn a commission. 722 F.3d 1079 (7th Cir. 2013). The court of appeals held that, although that would generally be a violation of a fiduciary duty of loyalty, such was not a breach of fiduciary duty where the specific trust document at issue allowed the bank to enter into self-dealing transactions:

> "'It is a fundamental principle of the law of trusts that the trustee is under a duty of undivided loyalty to the beneficiaries of the trust.'" The duty of loyalty requires the fiduciary "'to act solely for the benefit of the principal in all matters connected with the agency, even at the expense of the agent's own interests.'" One aspect of the duty of loyalty is the strict prohibition against self-dealing. This prohibition applies whether or not the self-dealing results in profits drawn from the trust itself or paid by a third party. *See* Restatement (Third) of Trusts § 78 cmt. d(1) ("A trustee engages in self-dealing and therefore normally violates the duty of loyalty by personally accepting from a third person any fee, commission, or other compensation for an act done by the trustee in connection with the administration of the trust.").
>
> But the trust instrument may waive the general rule and authorize the trustee to engage in transactions that involve self-dealing. General language granting broad powers to the trustee is not sufficient to waive the prohibition; to be effective, the authorization to self-deal must be express and clear.
>
> Here, the trust instrument contains an express conflicts waiver in the section of the document that describes the trustee's powers and duties … In short, the trust instrument expressly authorized Wachovia to proceed with the insurance transaction even though its insurance affiliate would earn a commission.

Id. at 1085-1086

In some instances, there are statutory provisions that allow for transactions where a trustee may receive an incidental or side benefit. Where there are statutes that allow for a trustee to engage in otherwise conflicted transactions, a trustee may do so without liability. *Humane Soc'y of Austin & Travis County v. Austin Nat'l Bank*, 531 S.W.2d 574 (Tex. 1975) (executor allowed to invest estate assets in its own certificates of deposit due to federal regulations allowing same and even where other institutions were offering higher interest rates).

There are statutory exceptions for certain inherently conflict-oriented transactions. A trustee should also keep in mind that if a trust document limits one of the statutory provisions allowing a conflicted transaction, the trust document controls. Tex. Prop. Code § 113.001 ("A power given to a trustee by this subchapter does not apply to a trust to the extent that the instrument creating the trust, a subsequent court order, or another provision of this subtitle conflicts with or limits the power.”).

Trust Code Section 113.015 provides that a trust may borrow money from a trustee. Tex. Prop. Code § 113.015 (“A trustee may borrow money from any source, including a trustee, purchase property on credit, and mortgage, pledge, or in any other manner encumber all or any part of the assets of the trust as is advisable in the judgment of the trustee for the advantageous administration of the trust.”). Presumably, the trustee who loans money to a trust can charge a reasonable interest rate for the loan.

Trust Code Section 113.053 provides that a national banking association or state-chartered bank “that is serving as executor, administrator, guardian, trustee, or receiver may sell shares of its own capital stock held by it for an estate to one or more of its officers or directors if a court: (1) finds that the sale is in the best interest of the estate that owns the shares; (2) fixes or approves the sales price of the shares and the other terms of the sale; and (3) enters an order authorizing and directing the sale.” Tex. Prop. Code § 113.053(b). “If a corporate trustee, executor, administrator, or guardian is legally authorized to retain its own capital stock in trust, the trustee may exercise rights to purchase its own stock if increases in the stock are offered pro rata to shareholders.” *Id*. at § 113.053(c).

“If the exercise of rights or the receipt of a stock dividend results in a fractional share holding and the acquisition meets the investment standard required by this subchapter, the trustee may purchase additional fractional shares to round out the holding to a full share.” *Id*. at § 113.053(d).

Under certain circumstances, a corporate trustee can “employ an affiliate or division within a financial institution to provide brokerage, investment, administrative, custodial, or other account services for the trust or custodial account and charge the trust or custodial account for the services. *Id*. at § 113.053(f). Further, under certain circumstances, a corporate trustee may “purchase insurance underwritten or otherwise distributed by an affiliate, a division within the financial institution, or a syndicate or selling group that includes the financial institution or an affiliate and charge the trust or custodial account for the insurance premium.” *Id*. Further, under certain circumstances, a corporate trustee may:

> Receive a fee or compensation, directly or indirectly, on account of the services performed or the insurance product sold by the affiliate, division within the financial institution, or syndicate or selling group that includes the financial institution or an affiliate, whether in the form of shared commissions, fees, or otherwise, provided that any amount charged by the affiliate, division, or syndicate or selling group that includes the financial institution or an affiliate for the services or insurance product is disclosed and does not exceed the customary or prevailing amount that is charged by the affiliate, division, or syndicate or selling group that includes the financial institution or an affiliate, or a comparable

> entity, for comparable services rendered or insurance provided to a person other than the trust.

Id. at § 113.053(f)(3). Finally, under certain circumstances, corporate trustees can invest in certain proprietary mutual funds and receive compensation for services provided to that fund:

> In addition to other investments authorized by law for the investment of funds held by a fiduciary or by the instrument governing the fiduciary relationship, and notwithstanding any other provision of law and subject to the standard contained in Chapter 117, a bank or trust company acting as a fiduciary, agent, or otherwise, in the exercise of its investment discretion or at the direction of another person authorized to direct the investment of funds held by the bank or trust company as fiduciary, may invest and reinvest in the securities of an open-end or closed-end management investment company or investment trust registered under the Investment Company Act of 1940 (15 U.S.C. Sec. 80a-1 et seq.) if the portfolio of the investment company or investment trust consists substantially of investments that are not prohibited by the governing instrument. The fact that the bank or trust company or an affiliate of the bank or trust company provides services to the investment company or investment trust, such as those of an investment advisor, custodian, transfer agent, registrar, sponsor, distributor, manager, or otherwise, and receives compensation for those services does not preclude the bank or trust company from investing or reinvesting in the securities if the compensation is disclosed by prospectus, account statement, or otherwise. An executor or administrator of an estate under a dependent administration or a guardian of an estate shall not so invest or reinvest unless specifically authorized by the court in which such estate or guardianship is pending.

Id. at § 113.053(g). *See generally Hughes v. LaSalle Bank, N.A.*, 419 F. Supp.2d 605, 619 (S.D.N.Y. 2006) (trustee did not engage in self-dealing where its investments in affiliated mutual fund were authorized by law), *vacated on other grounds*, 2007 WL 4103680 (2nd Cir. Nov. 19, 2007); *Estate of Vail v. First of Am. Trust Co.*, 722 N.E.2d 248, 251-252 (Ill. App. Ct. 1999) (executor did not act improperly by investing in an affiliated fund, noting that the law allows such investments); *see also J. Langbein, Questioning the Trust Law Duty of Loyalty: Sole Interest or Best Interest?*, 114 YALE L.J. 929, 972-73 (2005) (Congress and the states have recognized that mutual funds have "significant advantages" and have enacted statutes authorizing bank trustees to invest trust assets in affiliated mutual funds).

The Restatement of Trusts similarly provides guidance on this issue:

> *c(8). Statutory exception for proprietary mutual funds.* Under statutes enacted in most of the states, a trustee is not precluded from investing trust funds in the securities of an investment company or investment trust to which the trustee or an affiliate provides services in a capacity other than as trustee, even though the trustee (or an affiliate) is compensated for those services by the investment trust or company out of fees charged to the trust or investment, provided the investment is prudent (§ 77 and § 90, particularly *id*., Comment m). These statutes require the trustee to satisfy certain requirements set out in the statute concerning information the trustee must report to beneficiaries about the rate of compensation and the method by which the compensation was determined. (*See* Reporter's Note, with excerpt from the comparable Uniform Trust Code provision, including discussion and rationale in the UTC comment excerpt.)
>
> It is essential to note that this statutory exception for corporate trustees' participation in what are generally called "proprietary mutual funds" does not relieve the trustee of its normal duty to exercise prudence (§ 77, including compliance with the prudent investor rule of §§ 90-92). Nor does it dispense with the trustee's fundamental duty to act in the interest of the beneficiaries, its duty of impartiality, or the other fiduciary duties of trusteeship. For example, the trustee cannot properly confine its investments to the proprietary-mutual-fund offerings if this would impair the trustee's ability to manage both uncompensated and compensated risk through proper diversification and through asset allocation appropriate to the particular trust (§ 90); and the trustee must be sufficiently aware of overall costs associated with other mutual-fund alternatives to enable the trustee to fulfill its important responsibility to be cost conscious in managing the trust's investment program (see § 90(c)(3) and more generally § 88). Furthermore, the use of proprietary mutual funds for a trust's investment program must not result in the trustee receiving more than the reasonable overall compensation (§ 38) appropriate to its services to the trust, taking account of the trustee's mutual-fund duties and compensation. Further see Reporter's Note.

RESTATEMENT (THIRD) OF TRUSTS, § 78. Another commentator described the use of proprietary mutual funds. In light of the limitations on common trust funds, the financial services industry generally concluded that "[m]utual funds have significant advantages over common trust funds, and in 1996 Congress facilitated the spread of mutual funds for trust investing by allowing tax-free conversion of existing common trust funds to mutual funds." J. Langbein, *Questioning the Trust Law Duty of Loyalty: Sole Interest or Best Interest?*,114 Yale L.J. 929, 972-73 (March 2005). Recognizing the advantages of mutual funds over CTFs as investment vehicles for trust accounts, after 1996, the vast majority of states amended their laws to permit a trustee to invest trust assets in affiliated mutual funds. *Id*. These statutes contained varying requirements as to fees, notices and disclosures. *See id*. at 973-74. In other words, these laws provided bank trustees with a safe harbor to invest trust assets in affiliated mutual funds, so long as the various conditions were satisfied. *Id*. The author noted that the trustee still has the duty to monitor that the combined compensation is reasonable:

> Thus, even though the statute eliminates the sole interest rule, the trustee still has the duty to act in the best interest of the beneficiary when deciding whether to use affiliated funds. Although the trustee derives fee income both from the mutual fund and the trust, the trustee's duty of cost sensitivity requires that the aggregate expenses be appropriate and reasonable. The duty of monitoring incident to the use of pooled investment vehicles requires constant attention to the costs and the comparative performance of competing funds.

Id.

Under certain circumstances, a corporate trustee may deposit funds with itself. Tex. Prop. Code § 113.057. "A corporate trustee may deposit trust funds with itself as a permanent investment if authorized by the settlor in the instrument creating the trust or if authorized in a writing delivered to the trustee by a beneficiary currently eligible to receive distributions from a trust created before January 1, 1988." *Id*. at § 113.057(a). Further, "a corporate trustee may deposit with itself trust funds that are being held pending investment, distribution, or payment of debts if, except as provided by Subsection (d) of this section: (1) it maintains under control of its trust department as security for the deposit a separate fund of securities legal for trust investments; (2) the total market value of the security is at all times at least equal to the amount of the deposit; and (3) the separate fund is marked as such." *Id*. at § 113.057(b). "The trustee may make periodic withdrawals from or additions to the securities fund required by Subsection (b) of this section as long as the required value is maintained. Income from securities in the fund belongs to the trustee." *Id*. at § 113.057(c). Finally, "security for a deposit under this section is not required for a deposit under Subsection (a) or under Subsection (b) of this section to the extent the deposit is insured or otherwise secured under state or federal law." *Id*. at § 113.057(d). So, if a bank has FDIC insurance, it can use itself as a depository bank for trust funds without the need for a securities fund.

The Texas Property Code has certain provisions expressly not allowing particular transactions. For example, Texas Property

Code Section 112.087, provide that in a decanting situation, a trustee cannot decant solely to change compensation terms, but if other reasons are present, can change compensation terms to "bring them into conformance with reasonable limits authorized by state law." Also, a trustee may not receive a commission or other compensation for the distribution of an asset from the first trust to the second trust. *Id*.

Section 113.052 prohibits a trust from loaning money to a trustee or an affiliate. Tex. Prop. Code §113.052. Generally, a trustee may not buy or sell trust property to or from itself or an affiliate. Tex. Prop. Code §113.053(a); *Fisher v. Miocene Oil & Gas Ltd.*, 335 Fed. Appx. 483, 2009 U.S. App. LEXIS 14368 (5th Cir. Tex. 2009).

Section 113.055 provides that "a corporate trustee may not purchase for the trust the stock, bonds, obligations, or other securities of the trustee or an affiliate, and a noncorporate trustee may not purchase for the trust the stock, bonds, obligations, or other securities of a corporation with which the trustee is connected as director, owner, manager, or any other executive capacity." Tex. Prop. Code §113.055(a). However, A trustee may: "(1) retain stock already owned by the trust unless the retention does not satisfy the requirements prescribed by Chapter 117; and (2) exercise stock rights or purchase fractional shares under Section 113.053 of this Act." *Id.* at §113.057(b).

B. Estate Administrator/Executor Compensation

It may be helpful to compare trustee compensation to the right of estate representatives to compensation. Courts have found that estate representatives are essentially trustees and have the same fiduciary duties in Texas. *In re Estate of Boylan*, No. 02-14-00170-CV, 2015 Tex. App. LEXIS 1427 (Tex. App.—Fort Worth Feb. 12, 2015, no pet.). "An executor's fiduciary duty to the estate's beneficiaries arises from the executor's status as trustee of the property of the estate." *Id*. (citing *Humane Soc'y v. Austin Nat'l Bank*, 531 S.W.2d 574, 577 (Tex. 1975)). It has long been the rule in Texas that testators may specify the commission to be paid under a will or allow the commission amount to be determined by statute. *Bigbee v. Castleberry*, 2008 Tex. App. LEXIS 364, 2008 WL 152382 at *2 n. 1 (Tex. App.—Corpus Christi 2008, no pet.); *In re Estate of Roots*, 596 S.W.2d 240, 243 (Tex. App.—Amarillo 1980, no writ) (citing Ben G. Sewell & Paul W. Nimmons, Jr., *The Executor's and Administrator's Statutory Compensation in Texas*, 3 ST. MARY'S L.J. 1 (1971)); *see Lipstreu v. Hagan*, 571 S.W.2d 36, 38 (Tex. Civ. App.—San Antonio 1978, writ ref'd n.r.e.) ("[I]t is generally held that in the absence of a testamentary provision providing for compensation of the personal representative his right to compensation arises from, and is controlled by, statute."). In situations where a will does not set compensation, the Texas Estate's Code governs the compensation of executors of an estate. *Lee v. Lee*, 47 S.W.3d 767, 776 (Tex. App.—Houston [14th Dist.] 2001, pet. denied) ("Because it provides for a standard fee, section 241 applies in situations where the will does not set compensation, and the executor seeks compensation in the statutory amount or for a greater amount.") (citing *Weatherly v. Martin*, 754 S.W.2d 790, 793-94 (Tex. App.—Amarillo 1988, writ denied).

Under the statute, estate representatives are entitled to reasonable compensation for their work. Under Texas Estate Code Section 352.002, the standard compensation is "five percent commission on all amounts that he or she actually receives or pays out in cash in the administration of the estate." Tex. Est. Code § 352.002. This provision states:

> (a) An executor, administrator, or temporary administrator a court finds to have taken care of and managed an estate in compliance with the standards of this title is entitled to receive a five percent commission on all amounts that the executor or administrator actually receives or pays out in cash in the administration of the estate.
>
> (b) The commission described by Subsection (a): (1) may not exceed, in the aggregate, more than five percent of the gross fair market value of the estate subject to administration; and (2) is not allowed for: (A) receiving funds belonging to the testator or intestate that were, at the time of the testator's or intestate's death, either on hand or held for the testator or intestate in a financial institution or a brokerage firm, including cash or a cash equivalent held in a checking account, savings account, certificate of deposit, or money market account; (B) collecting the proceeds of a life insurance policy; or (C) paying out cash to an heir or legatee in that person's capacity as an heir or legatee.

Id.

A court may also alter this standard compensation formula for unusual estates:

> (a) The court may allow an executor, administrator, or temporary administrator reasonable compensation for the executor's or administrator's services, including unusual efforts to collect funds or life insurance, if: (1) the executor or administrator manages a farm, ranch, factory, or other business of the estate; or (2) the compensation calculated under Section 352.002 is unreasonably low.

Id. at § 352.003. The court may also deny compensation:

> The court may, on application of an interested person or on the court's own motion, wholly or partly deny a commission allowed by this subchapter if: (1) the court finds that the executor or administrator has not taken care of and managed estate property prudently; or (2) the executor or administrator has been removed under Section 404.003 or Subchapter B, Chapter 361.

Id. at § 352.004.

Texas Estate Code Section 404.035 provides that a court may remove an executor if "the independent executor becomes incapable of properly performing the independent executor's fiduciary duties due to a material conflict of interest." *Id*. at § 404.035.

V. DUTY TO DISCLOSE COMPENSATION

A trustee has a duty of full disclosure. Texas Property Code Section 113.051 states that trustees shall perform common law duties (absent contrary terms in trust document). Tex. Prop. Code §113.051. A Trustee also has a duty of full disclosure of all material facts known to it that might affect the beneficiaries' rights. *Montgomery v. Kennedy*, 669 S.W.2d 309, 313 (Tex. 1984); *see also Valdez v. Hollenbeck*, 465 S.W.3d 217 (Tex. 2015). A trustee also has a duty of candor. *Welder v. Green*, 985 S.W.2d 170, 175 (Tex. App—Corpus Christi 1998, pet. denied). Regardless of the circumstances, the law provides that beneficiaries are entitled to rely on a trustee to fully disclose all relevant information. *See generally Johnson v. Peckham*, 132 Tex. 148, 120 S.W.2d 786, 788 (1938). In fact, a trustee has a duty to account to the beneficiaries for all trust transactions, including profits, and mistakes. *Huie v. DeShazo*, 922 S.W.2d 920, 923 (Tex. 1996); *see also Montgomery*, 669 S.W.2d at 313. A trustee's fiduciary duty even includes the disclosure of any matters that could possibly influence the fiduciary to act in a manner prejudicial to the principal. *Western Reserve Life Assur. Co. v. Graben*, 233 S.W.3d 360, 374 (Tex. App.—Fort Worth 2007, no pet.). Disclosure is also important because without proper disclosure, a beneficiary's cause of action may not accrue. *Ward v. Stanford*, 443 S.W.3d 334 (Tex. App.—Dallas 2014, pet. denied).

So, a trustee has a duty to maintain appropriate records so that it can create an accounting showing its compensation from inception and should affirmatively regularly report its compensation to its beneficiaries. Corporate fiduciaries usually provide statements on a quarterly or monthly basis that discloses information about the trust's assets, income, and expenses and normally indicates trustee compensation. This is certainly sufficient to meet a duty to disclose.

Complying with a duty to disclose can have other benefits. It will certainly start the statute of limitations running on any breach of fiduciary duty claim.

Further, a beneficiary that knows of the compensation, and who does not object to same, may be precluded from later complaining of the compensation. The defense of laches requires: (1) an unreasonable delay by the moving party in asserting their rights and (2) the person raising the defense must be disadvantaged as a result of this delay by the moving party. *Culver v. Pickens*, 176 SW2d 167 (Tex. 1943); *Knesek v. Witte*, 754 S.W.2d 814, 816 (Tex. App.—Houston [1st Dist.] 1988, writ denied). Laches bars an action where the plaintiff acquiesces in the way and manner an estate is handled for many years. *Garver v. First Nat'l Bank*, 432 S.W.2d 745 (Tex. App.—Amarillo 1968, writ ref'd n.r.e.). In *Garver*, a husband and wife filed suit against a bank seeking recovery of an interest in the proceeds of oil and gas leases that had been deposited with the bank for the benefit of the heirs of the wife's parents. 432 S.W.2d at 746. The bank had handled the deposits for many years, as directed by the estate's executors, who were the wife's brothers. The court of appeals affirmed a summary judgment in favor of the bank, holding among other things that the plaintiffs' claims were barred by laches because the plaintiffs had acquiesced in the brothers' handling of the estate's proceeds for a period of nineteen years. *Id.* at 749. The court held that no one has the right to remain inactive when action is demanded while another party so changes his position that great damage will be inflicted by granting the remedial writ. *Id*.

The elements of ratification are: (1) approval by act, word, or conduct; (2) with full knowledge of the facts of the earlier act; and (3) with the intention of giving validity to the earlier act. *Sandi Samms v. Autumn Run Cmty. Improvement Ass'n.*, 23 S.W.3d 398, 403 (Tex. App.—Houston [1st. Dist.] 2000, pet. denied). Waiver is defined as an intentional relinquishment of a known right or intentional conduct inconsistent with claiming such right. *Sun Exploration & Prod. Co. v. Benton*, 728 S.W.2d 35, 37 (Tex. 1987). The elements of waiver are: (1) an existing right; (2) actual or constructive knowledge of the existence of the right; and (3) the intent of the alleged waiving party (which can be inferred from conduct). *Bass & Co. v. Dalsan Props.—Abilene*, 885 S.W.2d 572, 577 (Tex. App.—Dallas 1991, no writ). Estoppel prevents one party who has induced another to act in a particular way from adopting an inconsistent position, attitude, or course of conduct that will cause loss or injury to the other person. *Houtchens v. Matthews,* 557 S.W.2d 581, 585 (Tex. Civ. App.—Fort Worth 1977, writ dism.). The elements of equitable estoppel are: (1) a false representation or concealment of material facts, (2) made with the knowledge, actual or constructive, of those facts, (3) to a party without knowledge, or the means of knowledge, of those facts, (4) with the intention that it should be acted on, and (5) the party to whom it was made must have relied or acted on it to his prejudice. *Gulbenkian v. Penn*, 151 Tex. 412, 252 S.W.2d 929 (1952). Additionally, quasi-estoppel is a defense that prevents a party from obtaining a benefit by asserting a right to the disadvantage of another that is inconsistent with the party's previous position. *Vessels v. Anschutz Corp*., 823 S.W.2d 762 (Tex. App.—Texarkana 1992, writ denied). Quasi-estoppel refers to conduct such as ratification, election, acquiescence, or acceptance of benefits. *Steubner Realty 19 v. Cravens Road 88,* 817 S.W.2d 160, 164 (Tex. App.—Houston [14th Dist.] 1991, no writ). The doctrine applies when it would be unconscionable to allow a person to maintain a position inconsistent with one in which he acquiesced, or of which he accepted a benefit. *Id.* One who retains benefits under a transaction cannot avoid its obligations and is estopped to take an inconsistent position. *Vessels*, 823 S.W.2d at 762; *Theriot v. Smith*, 263 S.W.2d 181, 183 (Tex. Civ. App.—Waco 1953, writ dism'd).

For example, in *Goughnour v. Patterson*, the court of appeals affirmed a judgment for a trustee who was sued by a beneficiary based on a failed real estate investment. No. 12-17-00234-CV, 2019 Tex. App. LEXIS 1665 (Tex. App.—Tyler March 5, 2019, pet. filed). The court held that the beneficiary's breach of fiduciary duty claim was barred due to quasi-estoppel because she never complained about numerous earlier transactions. *Id*.

If account statements are consistently sent to the beneficiaries, those beneficiaries will be hard pressed to argue that they did not know about the compensation, they accepted the benefits of the trustee's work, and that they are now precluded by an equitable defense from complaining about the trustee's compensation.

VI. <u>BENEFICIARY'S CONSENT TO COMPENSATION</u>

Trustees and beneficiaries can enter into private agreements that provide protection for a trustee. *See* RESTATEMENT (THIRD) OF TRUSTS, § 38(f) ("The amount of compensation or indemnification to which the trustee would otherwise be entitled may be enlarged or diminished by agreement between the trustee and the beneficiaries. Such an agreement will bind only the beneficiaries who are parties to it, directly or by virtual representation. An agreement enlarging the trustee's compensation or indemnification will not bind a beneficiary who personally consented but was under incapacity and was not otherwise bound by representation; nor will it bind a consenting beneficiary if the trustee failed to disclose all the relevant circumstances that the trustee knew or should have known, or if the agreement is unfair to the beneficiary.").

A trustee and beneficiary may want to enter into a release agreement. A release is a contractual clause that states that one party is relieving the other party from liability associated with certain conduct. For a revocable trust, a settlor may revoke, modify, or amend the trust at any time before the settlor's death or incapacity. Tex. Prop. Code § 112.051. Accordingly, in a revocable trust situation, a settlor may modify or amend a trust to specifically release a trustee from almost any duty or conduct. *See Puhl v. U.S. Bank, N.A.*, 34 N.E.3d 530 (Ohio Ct. App. 2015) (court held that in a revocable trust, during her lifetime, the settlor had the authority to instruct the trustee to retain stocks, and the trustee had the duty to follow those instructions regardless of the risk presented by the nondiversification).

The Texas Trust Code expressly states that beneficiaries can release a trustee. A beneficiary who has full capacity and acting on full information may relieve a trustee from any duty, responsibility, restriction, or liability that would otherwise be imposed by the Texas Trust Code. Tex. Prop. Code Ann. § 114.005. To be effective, this release must be in writing and delivered to the trustee. *Id*. The trustee should be careful to properly word the release or else certain conduct may be outside of the scope of the release. *See, e.g., Estate of Wolf*, 2016 NYLJ LEXIS 2965 (July 19, 2016) (release did not protect trustee from diversification claim that arose after the effective dates for the release).

Further, writings between the trustee and beneficiary, including releases, consents, or other agreements relating to the trustee's duties, powers, responsibilities, restrictions, or liabilities, can be final and binding on the beneficiary if they are in writing, signed by the beneficiary, and the beneficiary has legal capacity and full knowledge of the relevant facts. Tex. Prop. Code § 114.032. Minors are bound if a parent signs, there are no conflicts between the minor and the parent, and there is no guardian for the minor. *Id*.

Once again, both of the Texas Trust Code provisions set forth above require that the beneficiary act "on full information" and full knowledge of the relevant facts. Tex. Prop. Code §§ 114.005, 114.032. This is important because releases can be voided on grounds of fraud, like any other contract. *Williams v. Glash*, 789 S.W.2d 261 (Tex. 1990). So, fiduciaries should be very careful to provide full disclosures to beneficiaries before execution of a release regarding all material facts concerning the released matter. The trustee should offer to provide access to its books and records and require the beneficiary to confirm that they had access to that information. *See Le Tulle v. McDonald*, 444 S.W.2d 794 (Tex. Civ. App.—Beaumont 1969, writ ref'd n.r.e.) (court reversed summary judgment based on release of trustee where disclosure was not adequate).

The Texas Trust Code allows for advance judicial approval. Tex. Prop. Code § 115.001. The Texas Civil Practice and Remedies Code allows a court to declare the rights or legal relations regarding a trust and to direct a trustee to do or abstain from doing particular acts or to determine any question arising from the administration of a trust. Tex. Civ. Prac. & Rem. Code Ann. §

37.005. For example, in *Cogdell v. Fort Worth Nat'l Bank*, the trustee settled claims and sought judicial approval of the settlement agreement. 544 S.W.2d 825, 829 (Tex. Civ. App.—Eastland 1977, writ ref'd n.r.e.). The court of appeals noted that the trustee sought court approval of a settlement agreement that released claims against trustee, because of potential conflict of interest, and holding that approval of settlement was a question for the court. *Id.*

VII. POTENTIAL RAMIFICATIONS FOR OVERCOMPENSATION

A court can compel a trustee to act, enjoin a trustee from breaching a duty, compel a trustee to redress a prior breach, order a trustee to account, appoint a receiver, suspend the trustee, remove the trustee, reduce or deny compensation, void an act of the trustee, impose a lien or a constructive trust, or order any other appropriate relief. Tex. Prop. Code §114.008. If a trustee breaches its duty of loyalty via a conflict of interest, beneficiaries may have a suit for damages payable to the trust for the harm done to the trust. *Fetter v. Brown*, No. 10-13-00392-CV, 2014 Tex. App. LEXIS 11209 (Tex. App.—Waco October 9, 2014, pet. denied). A claim for breach of trust is akin to a claim for breach of fiduciary duty. *See Burrow v. Arce*, 997 S.W.2d 229, 240 (Tex. 1999) (holding that a client need not prove actual damages to obtain forfeiture of attorney's fee for the attorney's breach of fiduciary duty to the client, relying, *inter alia*, on the general rule for breach of trust). The elements of a breach of fiduciary duty action are: (1) a fiduciary relationship between the plaintiff and defendant; (2) the defendant must have breached its fiduciary duty to the plaintiff; and (3) the defendant's breach must result in injury to the plaintiff or benefit to the defendant. *Punts v. Wilson*, 137 S.W.3d 889, 891 (Tex. App.—Texarkana 2004, no pet.).

Kinzbach liability refers to instances where a fiduciary "takes any gift, gratuity, or benefit in violation of his duty, or acquires any interest adverse to his principal, without a full disclosure," which amounts to "a betrayal of his trust and a breach of confidence, and he must account to his principal for all he has received." *Kinzbach Tool Co. v. Corbett-Wallace Corp.*, 160 S.W.2d 509, 514, 138 Tex. 565 (Tex. 1942). *Bigbee v. Castleberry*, 2008 Tex. App. LEXIS 364, 2008 WL 152382 at *2 n. 1 (Tex. App.—Corpus Christi 2008, no pet.). Absent a trust provision that absolves liability for good faith mistakes, good faith is not a defense. "Good faith, though required by a trustee, is no defense where he oversteps the bounds of his authority." *Republic Nat'l Bank & Trust Co. v. Bruce*, 105 S.W.2d 882, 885 (Tex. 1937). Indeed, "a breach of trust may be found even though the trustee acted reasonably and in good faith, perhaps even in reliance on advice of counsel." *In re Estate of Boylan*, No. 02-14-00170-CV, 2015 Tex. App. LEXIS 1427 (Tex. App.—Fort Worth Feb. 12, 2015, no pet.).

VIII. COMPENSATION FORFEITURE

A beneficiary can seek the disgorgement of any profit or benefit that the trustee earned. Tex. Prop. Code §114.001(c)(2). This is true even though the trust has suffered no damages and even though the trustee may have acted in good faith. *Slay*, 187 S.W.2d at 377. To prevail on a claim for breach of fiduciary duty, the plaintiff must prove that the defendant breached its fiduciary duty to the plaintiff. *Zhu v. Lam*, 426 S.W.3d 333, 339 (Tex. App.—Houston [14th Dist.] 2014, no pet.). However, when a plaintiff alleges self-dealing by the fiduciary, a presumption of unfairness arises. *Fleming v. Curry*, 412 S.W.3d 723, 732 (Tex. App.— Houston [14th Dist.] 2013, pet. denied). In such cases, the profiting fiduciary bears the burden to rebut the presumption by proving the fairness of the questioned transaction. *Tex. Bank & Trust Co. v. Moore*, 595 S.W.2d 502, 508-09 (Tex. 1980).

Additionally, a court may reduce or deny a trustee's compensation for breaches of duty. Tex. Prop. Code §§ 114.008, 114.061. A plaintiff only needs to prove a breach (and not causation or damages) when she seeks to forfeit some portion of trustee compensation. *Longaker v. Evans*, 32 S.W.3d 725, 733 n.2 (Tex. App.—San Antonio 2000, pet. withdrawn). Good faith, though not a defense to liability, may certainly come into play in assessing whether a trustee should have to disgorge any profits or compensation.

The Texas Property Code provides that a court may remove a trustee if: 1) the trustee materially violated a term of the trust or attempted to do so and that resulted in a material financial loss to the trust; 2) the trustee fails to make an accounting that is required by law or by the terms of the trust; or 3) the court finds other cause for removal. Tex. Prop. Code § 113.082. For example, in *Ditta v. Conte*, the trial court removed the trustee due to a conflict of interest (she had borrowed money from the trust). 298 S.W.3d 187 (Tex. 2009). The court of appeals held that limitations prevented the removal. The Texas Supreme Court held that limitations does not apply to removal actions and affirmed the trial court's removal: "While removal actions are sometimes premised on a trustee's prior behavior, they exist to prevent the trustee from engaging in further behavior that could potentially harm the trust. Any prior breaches or conflicts on the part of the trustee indicate that the trustee could repeat her behavior and harm the trust in the future." *Id*.

The basis of a fiduciary relationship is equity. *Texas Bank & Trust Co. v. Moore*, 595 S.W.2d 502 (Tex. 1980). When a fiduciary breaches its fiduciary duties, a trial court has the right to award legal and equitable damages. It is common for a plaintiff to not have any legal or actual damages, but that does not prevent a trial court from being able to fashion an equitable remedy to protect the fiduciary relationship that has been violated. A trial court may order that the fiduciary forfeit compensation otherwise earned, disgorge improper gains and profits, or disgorge other consideration related to the breach of duty. This section of the paper will discuss the equitable remedies of forfeiture and disgorgement available to a trial court to remedy a breach of fiduciary duty.

Texas cases often use the terms interchangeably, but there may be a distinction between "disgorgement" of ill-gotten profit and "forfeiture" of agreed compensation. George Roach, *Texas Remedies in Equity for Breach of Fiduciary Duty: Disgorgement, Forfeiture, and Fracturing*, 45 ST. MARY'S L.J. 367, 372-73 (2014).

A. <u>General Authority</u>

The Texas Supreme Court has upheld equitable remedies for breach of fiduciary duty. *Burrow v. Arce*, 997 S.W.2d 229, 237-45 (Tex. 1999) (upholding remedy of forfeiture upon attorney's breach of fiduciary duty). For example, in *Kinzbach Tool Co. v. Corbett-Wallace Corp.*, the Texas Supreme Court stated the principle behind such remedies:

> It is beside the point for [Defendant] to say that [Plaintiff] suffered no damages because it received full value for what it has paid

> and agreed to pay. . . . It would be a dangerous precedent for us to say that unless some affirmative loss can be shown, the person who has violated his fiduciary relationship with another may hold on to any secret gain or benefit he may have thereby acquired. It is the law that in such instances if the fiduciary "takes any gift, gratuity, or benefit in violation of his duty, or acquires any interest adverse to his principal, without a full disclosure, it is a betrayal of his trust and a breach of confidence, and he must account to his principal for all he has received."

138 Tex. 565, 160 S.W.2d 509, 514 (Tex. 1942) (quoting *United States v. Carter*, 217 U.S. 286, 306, 30 S. Ct. 515, 54 L. Ed. 769 (1910)). The Court later held that a fiduciary may be punished for breaching his duty: "The main purpose of forfeiture is not to compensate an injured principal . . . . Rather, the central purpose . . . is to protect relationships of trust by discouraging agents' disloyalty." *Burrow*, 997 S.W.2d at 238.

For instance, courts may disgorge all profits from a fiduciary when a fiduciary agent usurps an opportunity properly belonging to a principal, or competes with a principal. *See, e.g., Johnson v. Brewer & Pritchard, P.C.*, 73 S.W.3d 193, 200 (Tex. 2002) (stating the rule that courts may disgorge any profit where "an agent diverted an opportunity from the principal or engaged in competition with the principal, [and] the agent or an entity controlled by the agent profited or benefitted in some way"). A fiduciary may also be required to forfeit compensation for the fiduciary's work. *See, e.g., Burrow*, 997 S.W.2d at 237 ("[A] person who renders service to another in a relationship of trust may be denied compensation for his service if he breaches that trust.").

B. <u>Compensation Forfeiture</u>

1. <u>General Authority</u>

When a plaintiff establishes that a fiduciary has breached its duty, a court may order the fiduciary to forfeit compensation that it was paid or should be paid. Under the equitable remedy of forfeiture, a person who renders service to another in a relationship of trust may be denied compensation for service if she breaches that trust. *Burrow*, 997 S.W.2d at 237. The objective of the remedy is to return to the principal the value of what the principal paid because the principal did not receive the trust or loyalty from the other party. *Id.* at 237-38; *McCullough v. Scarbrough, Medlin & Assocs., Inc.*, 435 S.W.3d 871, 904 (Tex. App.—Dallas 2014, pet. denied). The party seeking forfeiture need not prove damages as a result of the breach of fiduciary duty. *Burrow*, 997 S.W.2d at 240; *Brock v. Brock*, No. 09-08-00474-CV, 2009 Tex. App. LEXIS 5444, at *5 (Tex. App.—Beaumont July 16, 2009, no pet.).

In *Burrow v. Arce*, former clients sued their attorneys alleging breach of fiduciary duty arising from settlement negotiations in a previous lawsuit. 997 S.W.2d at 232-33. The Texas Supreme Court held that "a client need not prove actual damages in order to obtain forfeiture of an attorney's fee for the attorney's breach of fiduciary duty to the client." *Id.* at 240. It repeated that "the central purpose of the remedy is to protect relationships of trust from an agent's disloyalty or other misconduct." *Id.* The Court cited Section 469 of the Restatement

(Second) of Agency, which states that if "conduct [that is a breach of his duty of loyalty] constitutes a willful and deliberate breach of his contract of service, he is not entitled to compensation even for properly performed services for which no compensation is apportioned." *Id*. at 237. The Court also stated:

> [T]he possibility of forfeiture of compensation discourages an agent from taking personal advantage of his position of trust in every situation no matter the circumstances, whether the principal may be injured or not. The remedy of forfeiture removes any incentive for an agent to stray from his duty of loyalty based on the possibility that the principal will be unharmed or may have difficulty proving the existence or amount of damages.

Id. at 238.

Where equitable remedies exist, "the remedy of forfeiture must fit the circumstances presented." *Id*. at 241. The court has listed several factors for consideration when fashioning a particular equitable forfeiture remedy:

> "[T]he gravity and timing of the violation, its willfulness, its effect on the value of the lawyer's work for the client, any other threatened or actual harm to the client, and the adequacy of other remedies." These factors are to be considered in determining whether a violation is clear and serious, whether forfeiture of any fee should be required, and if so, what amount. The list is not exclusive. The several factors embrace broad considerations which must be weighed together and not mechanically applied. For example, the "willfulness" factor requires consideration of the attorney's culpability generally; it does not simply limit forfeiture to situations in which the attorney's breach of duty was intentional. The adequacy-of-other-remedies factor does not preclude forfeiture when a client can be fully compensated by damages. Even though the main purpose of the remedy is not to compensate the client, if other remedies do not afford the client full compensation for his damages, forfeiture may be considered for that purpose.

Id. at 243-44. Citing to comment c to Section 243 of the Restatement (Second) of Trusts, the Court held:

> It is within the discretion of the court whether the trustee who has committed a breach of trust shall receive full compensation or whether his compensation shall be reduced or denied. In the exercise of the court's discretion the following factors are considered: (1) whether the trustee acted in good faith or not; (2) whether the breach of trust was intentional or negligent or

> without fault; (3) whether the breach of trust related to the management of the whole trust or related only to a part of the trust property; (4) whether or not the breach of trust occasioned any loss and whether if there has been a loss it has been made good by the trustee; (5) whether the trustee's services were of value to the trust.

Id. at 243. A party may seek forfeiture as a remedy for breach of a fiduciary duty, provided the party includes a request for forfeiture in its pleadings. *Lee v. Lee*, 47 S.W.3d 767, 780-81 (Tex. App.—Houston [14th Dist.] 2001, pet. denied); *Longaker v. Evans*, 32 S.W.3d 725, 733 n.2 (Tex. App.—San Antonio 2000, pet. withdrawn) (explaining that *Burrow v. Arce* did not apply where a party sought damages resulting from a fiduciary's misconduct and did not seek forfeiture).

The Supreme Court has held, "ordinarily, forfeiture extends to all fees for the matter for which the [fiduciary] was retained." *Burrow*, 997 S.W.2d at 241 (quoting RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS, § 49 cmt. e); *see also ERI Consulting Eng'rs, Inc. v. Swinnea*, 318 S.W.3d at 867, 873 (Tex. 2010) ("[C]ourts may disgorge all ill-gotten profits from a fiduciary when a fiduciary agent usurps an opportunity properly belonging to a principal, or competes with a principal."). As an example of when total fee forfeiture is not appropriate, the Court has cited a circumstance such as "when a lawyer performed valuable services before the misconduct began, and the misconduct was not so grave as to require forfeiture of the fee for all services." *Burrow*, 997 S.W.2d at 241. It stated that "[s]ome violations are inadvertent or do not significantly harm the client" and can "be adequately dealt with by . . . a partial forfeiture." *Id*. (quoting RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS, § 49 cmt. b). Ultimately, fee forfeiture must be applied with discretion, based on all of the circumstances of the case. *Id*. at 241-42; *Swinnea*, 318 S.W.3d at 874-75.

So, a plaintiff who asserts a breach of fiduciary duty claim may assert a claim that the defendant should forfeit its fees or compensation. The trial court should make that determination under the multiple-factor test based on the evidence in the case. The trial court can rule that the defendant should forfeit some, all, or none of the compensation. The remedy of forfeiture for a fiduciary's breach is dependent upon the facts and circumstances in each case. *See Burrow*, 997 S.W.2d at 241-42 ("Forfeiture of fees, however, is not justified in each instance in which a [fiduciary] violates a legal duty, nor is total forfeiture always appropriate.").

2. Recent Case

In *Ramin' Corp. v. Wills*, an employer sued a former employee for breach of fiduciary duty and other claims based on the employee competing with the employer while she was an employee. No. 09-14-11168-CV, 2015 Tex. App. LEXIS 10612 (Tex. App.—Beaumont October 15, 2015, no pet.). The trial court found that the employee did breach her fiduciary duty, but held that the employer sustained no damages. The trial court also found for the employee on several of her counterclaims. Both parties appealed.

The court of appeals acknowledged that an employee does not owe an absolute duty of loyalty to her employer, and that absent an agreement to the contrary, an at-will employee may plan to compete with her employer, may take active steps to do so while still employed, may secretly join with other employees in a plan to compete with the employer, and has no general duty to disclose such plans. *Id.* at *27. However, the at-will employee may not act for his future interests at the expense of his employer or engage in a course of conduct designed to hurt his employer. *Id.*

One of the employer's arguments was that the trial court erred in not awarding a forfeiture of profits. The court of appeals first held that a party must plead for forfeiture relief and held that the employer had adequately done so. *Id.* at *26. The court then addressed the merits of the argument. It held that under the equitable remedy of forfeiture, a person who renders service to another in a relationship of trust may be denied compensation for her service if she breaches that trust. *Id.* The court further stated that the objective of the remedy is to return to the principal the value of what the principal paid because the principal did not receive the trust or loyalty from the other party. *Id.* Disgorgement also involves a fiduciary turning over any improper profit that the fiduciary earned arising from a breach. *Id.* at *29. The party seeking forfeiture and equitable disgorgement need not prove any damages as a result of the breach of fiduciary duty. *Id.* at *25.

The court explained that a trial court has discretion in awarding disgorgement or forfeiture and may consider several factors, including (1) whether the agent acted in good faith; (2) whether the breach of trust was intentional or negligent or without fault; (3) whether the breach of trust related to the management of the whole or related only to a part of the principal's interest; (4) whether the breach of trust by the agent occasioned any loss to the principal and whether such loss has been satisfied by the agent, and (5) whether the services of the agent were of value to the principal. *Id.* at *26 A court may also consider evidence of the fiduciary's salary, profits, or other income during the time the breach occurred. *Id.*

The court affirmed the employer not receiving any disgorgement or forfeiture damages. The court held that there was evidence that the employee was not enriched by her activities: "we conclude that there is an absence of evidence to establish that Wills' breach of her fiduciary duty was directly connected to her recovery of overtime, or that Ramin incurred any loss resulting from Wills' breach, and there is no evidence that Wills' services she performed for Ramin during the overtime hours were of no value to Ramin." *Id*. at *30-31.

In *White v. Pottorff*, the court of appeals affirmed a compensation disgorgement where a manager breached fiduciary duties. 479 S.W.3d 409 (Tex. App.—Dallas August 18, 2015, pet. denied). The court stated:

> The trial court also ordered White to disgorge the $375,000 fee he received to manage WEIG. Appellants argue White should not be required to disgorge this sum because there is no evidence he received this fee as a result of any wrongdoing. A fiduciary may be required to forfeit the right to compensation for the fiduciary's work when he has violated his duty. Appellants do not challenge the trial court's finding that White breached his fiduciary duties with respect to the Scoular Transaction or in other non-Repurchase-related ways as found in Finding 175.

> Appellants only argue that White did not breach his fiduciary duties by failing to provide notice of Section 10.4 to WEIG and its members. Because the trial court concluded White breached his fiduciary duties with respect to the Scoular Transaction (and otherwise), the trial court did not err by ordering White to forfeit the $375,000 compensation he received for managing WEIG.

Id. at 419.

In *Dernick Res., Inc. v. Wilstein*, the court affirmed a fee disgorgement award in breach of fiduciary duty case arising from a joint venture. 471 S.W.3d 468, 495 (Tex. App.—Houston [1st Dist.] 2015, pet. denied). The court of appeals held:

> Whether a fee forfeiture should be imposed must be determined by the trial court based on the equity of the circumstances. However, certain matters—such as whether or when the alleged misconduct occurred, the fiduciary's mental state and culpability, the value of the fiduciary's services, and the existence and amount of harm to the principal—may present fact issues for the jury to decide. Once the factual disputes have been resolved, the trial court must determine whether the fiduciary's conduct was a clear and serious breach of duty to the principal, whether any of the fees should be forfeited, and if so, what the amount should be.

Id. at 482. The court of appeals noted that the issues in the appeal were narrow:

> The only question left to be answered was whether Dernick's breach of its fiduciary duty by seizing the opportunity to purchase the majority interest in the McCourt Field and appoint Pathex as operator was "clear and serious" so as to justify equitable fee forfeiture and, if so, what amount of fees should be forfeited. These are questions that are properly determined by the trial court.

Id. at 483. Among other facts, the court noted as follows:

> There was evidence that Dernick's breach of its fiduciary duty in failing to notify the Wilsteins in writing of the opportunity to make the Snyder acquisition, and its seizure of the opportunity to become majority owner and appoint the operator of the field, was not a single limited, "technical" failure arising from the parties' business practice, as Dernick argues. Rather, it was part of repeated conduct on Dernick's part that involved concealing or failing to disclose information it was required to disclose, using the Wilsteins' interest to enrich itself, and threatening further harm to the Wilsteins'

> interest in the field. Thus, there is evidence that the violation had repercussions that were felt by the Wilsteins over a period of years, from 1997 until the time of trial in 2013, and that it was willful.

Id. at 484. The court affirmed the disgorgement award. It also affirmed the award of prejudgment interest on the disgorgement award. *Id*.

Other recent cases have similarly affirmed fee forfeiture awards. *Gammon v. Henry I. Hank Hodes & Diag. Experts of Austin, Inc*., No. 03-13-00124-CV, 2015 Tex. App. LEXIS 4235 (Tex. App.— Austin Apr. 24, 2015, pet. denied); *McCullough v. Scarbrough, Medlin & Associates, Inc*., 435 S.W.3d 871, 912 (Tex. App.—Dallas 2014, pet. denied).

IX. CONCLUSION

In an ever-changing society with new types of assets (crypto-currency) and ever changing investment strategies and opportunities, trustees have an increasingly difficult job administering trusts. Society has to allow trustees to be compensated, or else they will not do the work and take on the risk. The difficult issue is determining how much compensation is reasonable. This paper attempts to discuss the issues of the duty of loyalty, the right to compensation, the duty to disclose, and compensation forfeiture.