ADMINISTERING TRUSTS IN RECESSIONS: TRUST LOANS TO BENEFICIARIES

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

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I. INTRODUCTION

Beneficiaries often request that a trustee make them a loan from trust property. In an economic downturn, such requests are even more prevalent. As a general rule, a trustee should not want to make a loan to a beneficiary as it should assume that the beneficiary will default and the trustee will then be placed in a situation of having to collect on a debt from a beneficiary, a person to whom the trustee owes a fiduciary duty. Yet, the trustee may have pressure to make such a loan: the loan document may require it or suggest that same should be made, the beneficiary may have a right to remove the trustee, the settlor may want the loan to occur, the trustee may like the beneficiary and want to assist him or her, the trustee may have other non-trust relationships with the beneficiary or the beneficiary's family, etc. There are many different ways that a beneficiary or others may exert pressure on the trustee to make such a loan.

There are many different issues that arise from this type of transaction: a trustee's duty to follow the terms of the trust, statutes, and common law; a trustee's duty to properly manage trust assets; a trustee's obligation to work with co-trustees; a trustee's duty of impartiality among multiple beneficiaries; a trustee's duty to conduct due diligence, a trustee's ability to limit risk associated with such a transaction; a trustees right to make distributions and care for a beneficiary, and a trustee's right to offset debts owed by a beneficiary. This article addresses these many concerns and provides suggestions to trustees who find themselves in this unenviable position.

II. AUTHORITY FOR A TRUSTEE TO MAKE A LOAN TO A BENEFICIARY

A. Trust Language

A trustee should first review the terms of a trust and determine whether it has a right and/or duty to make loans to a beneficiary. Generally, a trust document's terms govern, and a trustee should follow them. Tex. Prop. Code Ann §§ 111.0035(b), 113.001; RESTATEMENT (THIRD) OF TRUSTS § 76(1) (2007) ("The trustee has a duty to administer the trust … in accordance with the terms of the trust . . . ."); RESTATEMENT (SECOND) OF TRUSTS § 164(a) (1959). The trustee shall administer the trust in good faith according to its terms and the Texas Trust Code. Tex. Prop. Code Ann. § 113.051. Moreover, a court may remove a trustee where "the trustee materially violated or attempted to violate the terms of the trust and the violation or attempted violation results in a material financial loss to the trust…" Tex. Prop. Code Ann. § 113.082(a)(1).

"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.). "The powers conferred upon the trustee in the trust instrument must be strictly followed." *Id*. "The nature and extent of a trustee's duties and powers are primarily determined by the terms of the trust." RESTATEMENT (THIRD) OF TRUSTS § 90 cmt. B; *Stewart v. Selder*, 473 S.W.2d 3 (Tex. 1971); *Beaty v. Bales,* 677 S.W.2d 750, 754 (Tex. App.—San Antonio 1984, no writ). If the language of the trust instrument unambiguously expresses the intent of the settlor, the instrument itself confers the trustee's powers and neither the trustee nor the courts may alter those powers. *Jewett v. Capital National Bank of Austin*, 618 S.W.2d 109, 112 (Tex. Civ. App.—Waco 1981, writ ref'd n.r.e.); *Corpus Christi National Bank v. Gerdes,* 551 S.W.2d 521, 523 (Tex. Civ. App.—Corpus Christi 1977, writ ref'd n.r.e.). Accordingly, if a trust document provides instructions regarding loans to beneficiaries, the trustee should generally follow those instructions and avoid liability for doing so. *Beaty v. Bales*, 677 S.W.2d 750 (Tex. App.—San Antonio 1984, writ ref'd n.r.e.) (court affirmed trustee's loaning trust funds to beneficiary where trust document allowed for same).

A settlor may want to protect a trustee from potential claims or threats of claims by expressly allowing a trustee to make loans to the beneficiaries. *Bartlett v. Dumaine*, 128 N.H. 497, 501, 523 A.2d 1 (1986) (trust document provided discretion to a trustee in investing trust assets). For example, trust documents may state:

> The trustee shall have the power to lend money or other property to any person, beneficiary (including a beneficiary then serving as a trustee hereunder), to an estate, or to any trust created or continued hereunder, provided that any such loan shall be adequately secured and shall bear a reasonable rate of interest.
>
> or
>
> Loans. The Trustee has the authority to lend money to any person or entity upon such terms and with such security as the Trustee deems advisable.

For grantor trusts, drafters often limit a settlor's ability to borrow from the trust unless there is adequate interest and security.

> Borrow. The Trustee shall not allow Settlor to borrow trust principal or income, directly or indirectly, without adequate interest and security.

Therefore, settlors can incorporate provisions that grant a trustee the authority to make loans to beneficiaries and provide conditions for such transactions.

Where a trust contains specific provisions such as these, a trustee has a duty to follow those terms. Trustees, however, may want to be wary of these types of provisions. A trustee's ability to make a loan to a beneficiary is a fruitful area for litigation risk. A non-loan-receiving beneficiary may sue and argue that the trustee abused its discretion or otherwise violated its fiduciary duties in making the loan notwithstanding exculpatory clauses or other clauses that allow such a transaction. Conversely, if the trustee does not act to make the loan, the beneficiary who requested it may sue the trustee for not exercising that authority. Exercising or failing to exercise this type of authority is often viewed as a lose/lose proposition.

B. <u>Statutory Authority For Trust Loans To Beneficiaries</u>

After reviewing the trust document, a trustee should be aware of statutory law governing its powers to make loans to beneficiaries. To the extent the trust instrument is silent, the provisions of the Trust Code govern. Tex. Prop. Code Ann. § 113.001; *Conte v. Conte*, 56 S.W.3d 830, 832 (Tex. App.—Houston [1st Dist.] 2001, no pet.).

There are Texas Property Code provisions that are more general in nature, but that support a trustee's power to make loans to beneficiaries. A trustee has the general power to do anything that is necessary or appropriate to carry out the purpose of the trust. Tex. Prop. Code Ann. § 113.002. A trustee has the power to reinvest trust assets in property of any character. Tex. Prop. Code Ann. § 113.006. Further, a trustee must manage the property "as a prudent investor would, by considering the purposes, terms, distribution requirements, and other circumstances of the trust," and must "exercise reasonable care, skill, and caution" in doing so. Tex. Prop. Code Ann. § 117.004. Further, "[e]xcept as otherwise provided by and subject to this subtitle, a trustee may invest in any kind of property or type of investment consistent with the standards of this chapter." *Id*. The Texas Property Code also states: "The powers, duties, and responsibilities under this subtitle do not exclude other implied powers, duties, or responsibilities that are not inconsistent with this subtitle." *Id*. § 113.024.

Other states have express statutes that discuss a trustee making a loan to a beneficiary. For example, California has a statute authorizing such loans: "The trustee has the following powers: (a) To make loans out of trust property to the beneficiary on terms and conditions that the trustee deems are fair and reasonable under the circumstances. (b) To guarantee loans [by others] to the beneficiary by encumbrances on trust property." Cal. Prob. Code § 16244. Like other statutory powers, the power to lend money to the beneficiary may be limited (or forbidden) by explicit terms of the trust instrument. Cal. Prob. Code § 16200(b). *See also* 2005 Mo. Rev. St. § 456.8-816; New Hampshire Rev. Stat. Ann. § 564-B:8-816(a)(18); Oregon Rev. Stat. 130.725 (2017) ("Make loans out of trust property. The trustee may make a loan to a beneficiary on terms and conditions the trustee considers to be fair and reasonable under the circumstances. The trustee may collect loans made to a beneficiary by making deductions from future distributions to the beneficiary.").

The Uniform Trust Code Section 816 allows a trustee to make loans to a beneficiary or to guarantee loans of a beneficiary upon such terms and conditions as the trustee considers fair and reasonable. UTC § 816(18), (19). The comments state:

> The determination of what is fair and reasonable must be made in light of the fiduciary duties of the trustee and the purposes of the trust. Frequently, a trustee will make loans to a beneficiary which might be considered less than prudent in an ordinary commercial sense although of great benefit to the beneficiary and which help carry out the trust purposes. If the trustee requires security for the loan to the beneficiary, adequate security under this paragraph may consist of a charge on the beneficiary's interest in the trust. *See* RESTATEMENT (SECOND) OF TRUSTS Section 255 (1959). However, the interest of a beneficiary subject to a spendthrift restraint may not be pledged as security for a loan. *See* Section 502.

Id.

Accordingly, where a trust is silent on loans to beneficiaries, statutes do provide a general power that authorizes a trustee to make a loan to a beneficiary. The issue, to be discussed below, is whether the trustee should, in any particular instance, exercise that power to make the requested loan.

C. Common Law Support For Trust Loans To Beneficiaries

Unless limited by the trust document or statute, a trustee has the powers recognized by the common law. The Texas Trust Code expressly adopts a trustee's common-law duties: "The 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 the trustee shall perform all of the duties imposed on trustees by the common law." Tex. Prop. Code Ann. § 113.051.

"Apart from statutorily authorized powers, a trustee can exercise only those powers expressly granted by the settlor or those necessarily implied in the trust instrument and neither the trustee nor the courts can add to or take from these powers but must permit them to stand as written, subject only to the construction intended by the settlor." *Kuhns v. Carnes*, No. 03-97-00721-CV,1999 Tex. App. LEXIS 6901, 1999 WL 699809 (Tex. App.—Austin Sept. 10, 1999, pet. denied) (not designated for publication) (citing *Beaty v. Bales*, 677 S.W.2d 750, 754 (Tex. App.—San Antonio 1984, writ ref'd n.r.e.) (citing *Jewett v. Capital Nat'l Bank*, 618 S.W.2d 109, 112 (Tex. App.—Waco 1981, writ ref'd n.r.e.))).

The power of a trustee to invest necessarily carries with it the authority to lend in proper circumstances and to agree to the time of repayment and other terms usually incident to loans of money. *Beaty v. Bales*, 677 S.W.2d 750 (Tex. App.—San Antonio 1984, writ ref'd n.r.e.); *Ziegler v. Southwest Film Laboratory, Inc.*, 351 S.W.2d 636 (Tex. Civ. App.—Texarkana 1961, writ ref'd n.r.e.).

In *Beaty*, the court held that a loan of trust funds to the trustee's sibling who was a beneficiary and who was having financial difficulties was valid where the trust instrument expressly permitted invasion of the corpus for the benefit of beneficiaries having such difficulties:

> On point of error seven appellant questions a loan made by the trustee to his sister, Mary Lee Bales Winans in the sum of $2,700.00. This assertion of error is without merit. The record reflects that Mary Lee Bales Winans is an income beneficiary and remainderman. Both wills specifically provided that the corpus of the estate could be invaded for the benefit of beneficiaries having financial difficulties. The loan was included in the accountant's financial report. Article 7425b-10, supra, Loan of Trust Funds, specifically provides that nothing contained in the act shall prohibit any trustee from lending such funds to any beneficiary of a trust when so authorized or directed by the express terms of the instrument… In this case the trustee derived his authority from an express provision in the will.

Beaty v. Bales, 677 S.W.2d at 757. *See also Matter of A.H. Killian Trust,* 519 N.W.2d 409 (Iowa App. 1994) (court approved loans to a beneficiary for home repairs). *But see Republic Nat'l Bank v. Fredericks*, 274 S.W.2d 431 (Tex. Civ. App.—Dallas 1954, no writ) (court held that due to the trust's language, a trustee could not invade principle of the trust to pay for an income beneficiary's health needs where the beneficiary was only entitled to income and that trustee could also not make a loan for the beneficiary's benefit).

Furthermore, American Jurisprudence provides:

> Trust investments in certain loans have long been recognized as a valid practice, and indeed, it is the duty of a trustee to properly invest trust funds in loans unless he or she otherwise invests them. The duty to lend the trust funds at interest may be expressly enjoined by the terms of the trust. General principles of trust law include a strong presumption in favor of trustees accepting collateral security when making a loan.

76 AM. JUR. 2d, Trusts § 450

Generally, there is common-law authority that supports a trustee's ability to make loans as an investment of trust funds. Further, a trustee has implied authority to make loans to beneficiaries.

D. <u>Trustee's Discretion To Make Loans</u>

Whether in a trust document, statute, or common law, a trustee normally has discretion regarding whether to make a loan to a beneficiary. *Beaty v. Bales*, 677 S.W.2d at 757. The trustee should exercise this discretion in good faith and based on relevant factors and the trust document. Tex. Prop. Code § 113.029(a) ("Notwithstanding the breadth of discretion granted to a trustee in the terms of the trust, including the use of terms such as "absolute," "sole," or "uncontrolled," the trustee shall exercise a discretionary power in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries.").

Some courts have held that a court may not substitute its discretion for that of the trustee, and may interfere with the trustee's discretionary powers only in the case of fraud, misconduct, or clear abuse of discretion. *Lesikar v. Moon*, 237 S.W.3d 361 (Tex. App.—Houston [14th Dist.] 2007, pet. denied); *Beaty v. Bales*, 677 S.W.2d 750, 754 (Tex. App.—San Antonio 1984, writ ref'd n.r.e.); *Coffee v. William Marsh*

Rice Univ., 408 S.W.2d 269, 284 (Tex. Civ. App.—Houston 1966, writ ref'd n.r.e.); *see also Brown v. Scherck*, 393 S.W.2d 172, 184 (Tex. Civ. App.—Corpus Christi 1965, no writ) (observing that appellants had not undertaken to allege or prove the trustees had abused their discretion or acted dishonestly, in bad faith or arbitrarily, and a court will not interfere with trustees in the exercise of a discretionary power except where proper grounds are pleaded and proved).

However, courts have also held: "Even where a trustee is vested with broad discretion, courts may assert control over the trustee's exercise of power 'to prevent the frustration of the fundamental intent of the settlor' and compel the trustee's performance of his duty." *In re Estate of Bryant*, No. 07-18-00429-CV, 2020 Tex. App. LEXIS 2131 (Tex. App.—Amarillo March 11, 2020, no pet. history) (citing *Boyd v. Frost Nat'l Bank*, 145 Tex. 206, 196 S.W.2d 497, 504 (Tex. 1946)).

Regarding a trustee's discretionary decisions, one commentator has stated:

> If a trust instrument gives the trustee discretion to perform an act, a court generally will not substitute its judgment for that of the trustee unless there is a showing of fraud, misconduct, or clear abuse of discretion. In determining whether discretion has been abused, the court will consider the reasonableness of the exercise in light of the trustor's intention, considering the language of the whole trust instrument and aided by the surrounding circumstances. Thus, a trustor may not invest a trustee with absolute or uncontrolled discretion.

1 Texas Estate Planning § 35.12

E. <u>Statutory Authority For Loans To A Trustee's Affiliates</u>

The Texas Property Code discusses a trustee's ability to make loans from a trust to the trustee or his or her affiliates. It provides:

> Except as provided by Subsection (b) of this section, a trustee may not lend trust funds to: (1) the trustee or an affiliate; (2) a director, officer, or employee of the trustee or an affiliate; (3) a relative of the trustee; or (4) the trustee's employer, employee, partner, or other business associate.
>
> (b) This section does not prohibit: (1) a loan by a trustee to a beneficiary of the trust if the loan is expressly authorized or directed by the instrument or transaction establishing the trust; or (2) a deposit by a corporate trustee with itself under Section 113.057 of this Act.

Tex. Prop. Code § 113.052. The Texas Property Code also defines the term "affiliate":

> (1) "Affiliate" includes: (A) a person who directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with another person; or (B) any officer, director, partner, employee, or *relative of a person*, and any corporation or partnership of which a person is an officer, director, or partner.

Id. § 111.004(1).

Under these statutes, unless a trust expressly allows such, a trustee cannot make a loan of trust funds to an affiliate, which is defined as a relative of the trustee. Therefore, where the trustee and the beneficiary are related, the trustee cannot make a loan to the beneficiary unless the trust document expressly allows such a loan. *See, e.g., King v. King,* 295 Ore. App. 176, 185, 434 P3d 502 (2018, rev. denied) (trustee could not make loan to herself as a beneficiary due to statute prohibiting such a transaction).

The Texas Property Code provides that the "terms of a trust prevail over any provision of this subtitle, except that the terms of a trust may not limit" a number of provisions not including Section 113.052. *Id*. § 111.0035(b). Therefore, a trust document may limit the Texas Property Code's prohibition of a trustee making a loan to an affiliate. *See id.* Practically speaking, any such trust language that would lift that prohibition would likely also comply with Section 113.052(b), which states that there is no prohibition of a trust loan to a beneficiary where "the loan is expressly authorized or directed by the instrument or transaction establishing the trust." *Id*. § 113.052(b).

F. Co-Trustee Authority To Act And Responsibilities

Trusts often have co-trustees who are obligated to manage the trust together. Where a trustee has a co-trustee, both should generally act together in deciding to make loans to a beneficiary. In the absence of trust direction, co-trustees generally act by majority decision. Tex. Prop. Code § 113.085(a). If a vacancy occurs in a cotrusteeship, the remaining co-trustees may act for the trust. *Id*. § 113.085(b). Moreover, a co-trustee has a duty to participate in the performance of a trustee's function. *Id*. § 113.085(c). So, generally, a co-trustee must participate in the decision to make a loan to a beneficiary.

There are two exceptions to a co-trustee's duty to participate, which are if the co-trustee:

> (1) is unavailable to perform the function because of absence, illness, suspension under this code or other law, disqualification, if any, under this code, disqualification under other law, or other temporary incapacity; or
>
> (2) has delegated the performance of the function to another trustee in accordance with the terms of the trust or applicable law, has communicated the delegation to all other cotrustees, and has filed the delegation in the records of the trust.

Tex. Prop. Code § 113.085(c). If a co-trustee is unavailable to participate under Subsection (c)(1) and prompt action is necessary to achieve the efficient administration or purposes of the trust or to avoid injury to the trust property or a beneficiary, the remaining co-trustee or a majority of the remaining co-trustees may act for the trust. *Id*. § 113.085(d). Further, a co-trustee may delegate to another the performance of a function unless the settlor specifically directs that the co-trustees jointly perform the function. *Id.* § 113.085(e). "Unless a cotrustee's delegation under this subsection is irrevocable, the cotrustee making the delegation may revoke the delegation." *Id*.

So, a co-trustee can opt out of participation in a loan decision if the co-trustee is unavailable. Further, a co-trustee may delegate a function to a co-trustee, which may generally be revoked. However, a delegation may not be absolute protection for the lending decision.

Co-trustees can be liable for the acts of their co-trustees. The Texas Property Code states:

> (a) A trustee who does not join in an action of a cotrustee is not liable for the cotrustee's action, unless the trustee does not exercise reasonable care as provided by Subsection (b).
>
> (b) Each trustee shall exercise reasonable care to: (1) prevent a cotrustee from committing a serious breach of trust; and (2)

compel a cotrustee to redress a serious breach of trust.

(c) Subject to Subsection (b), a dissenting trustee who joins in an action at the direction of the majority of the trustees and who has notified any cotrustee of the dissent in writing at or before the time of the action is not liable for the action.

Tex. Prop. Code § 114.006.

Therefore, even if a co-trustee attempts to delegate lending authority to a co-trustee, the delegating co-trustee may still be liable for failing to prevent its co-trustee from a serious breach of fiduciary duty.

A co-trustee who does not agree with a lending decision should participate in the decision, document that it voted against the decision, document that it notified the co-trustee of its dissent, and if the lending transaction is a serious breach of fiduciary duty, bring suit against the co-trustee to prevent the breach. Section XII of this paper addresses other options to avoid such a suit.

III. TRUSTEE'S FIDUCIARY DUTIES OF LOYALTY, DISCLOSURE, AND CONFIDENTIALITY

A. General Authority On The Duty Of Loyalty

The first and most fundamental duty that a trustee owes its beneficiaries is the duty of loyalty. Texas Property Code 113.051 provides: "The 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 the trustee shall perform all of the duties imposed on trustees by the common law." Tex. Prop. Code § 113.051. So, to determine a trustee's duty of loyalty, a trustee must first look to the trust document, relevant statutory provisions, and the common law. Trust documents often limit the duty of loyalty by containing exculpatory clauses that eliminate liability for negligent actions and that allow a trustee to make self-dealing transactions with a trust's assets.

In the absence of guidance from a trust document, a trustee should review relevant statutes. Texas Property Code Section 117.007 provides: "A trustee shall invest and manage the trust assets solely in the interest of the beneficiaries." *Id*. § 117.007.

One must look to the common law to determine the breadth of the duty of loyalty. Under the common law, courts hold a trustee to a high fiduciary standard. *Ditta v. Conte*, 298 S.W.3d 187, 191 (Tex. 2009). The fiduciary relationship exists between the trustee and the trust's beneficiaries, and the trustee must not breach or violate this relationship. *Slay v. Burnett Trust*, 143 Tex. 621, 187 S.W.2d 377, 387-88 (Tex. 1945); RESTATEMENT (SECOND) OF TRUSTS § 170 CMT. A (1959); G. BOGERT, TRUSTS AND TRUSTEES § 543, at 217-18 (2d ed. rev. 1993). The fiduciary relationship comes with many high standards, including loyalty and utmost good faith. *Kinzbach Tool Co. v. Corbett-Wallce Corp.*, 160 S.W.2d 509, 512 (Tex. 1942).

A trustee owes a trust beneficiary an unwavering duty of good faith, loyalty, and fidelity over the trust's affairs and its corpus. *Herschbach v. City of Corpus Christi*, 883 S.W.2d 720, 735 (Tex. App.—Corpus Christi 1994, writ denied) (citing *Ames v. Ames,* 757 S.W.2d 468, 476 (Tex. App.—Beaumont 1988), modified, 776 S.W.2d 154 (Tex. 1989)). 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).

Trustees in Texas can look to the Restatement (Third) of Trusts for guidance, as Texas courts routinely do so. *See, e.g., 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 Jan. 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).

Regarding the duty of loyalty, the Restatement of Trusts states:

> (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.

RESTATEMENT (THIRD) OF TRUSTS, § 78.

Therefore, as a general proposition, a trustee should not administer the trust to benefit anyone but the beneficiaries. Where there are multiple beneficiaries, the trustee owes each of them a duty of loyalty.

B. Duty To Disclose

A trustee has a duty to disclose to a beneficiary. 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). Further, a trustee 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 transactions, 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.). The duty to disclose reflects the information a trustee is duty-bound to maintain, as he or she is required to keep records of trust property and his or her actions. *Beaty v. Bales,* 677 S.W.2d 750, 754 (Tex. App.—San Antonio 1984, writ ref'd n.r.e.).

For example, in *Shannon v. Frost Nat'l Bank*, a court of appeals found that there was a fact issue on whether a trustee breached duties by failing to inform a beneficiary that she was entitled to distributions of trust assets instead of loans from the trustee, individually, to the trust. 533 S.W.2d 389 (Tex. Civ. App.—San Antonio 1975, writ ref'd n.r.e.). The court stated:

> Here, the result of the initial failure to make a full disclosure resulted in a series of loans by Bank, as a lending institution, to itself, as trustee, with both principal and interest to be paid out of funds of the trust estate. The net result, a benefit to Bank in its role as a lending institution. Stated differently, the situation is one in which the fiduciary suggested that the trust borrow from the fiduciary, and, in making such suggestion,

> withheld facts of which the beneficiary was ignorant. It cannot be said that, as a matter of law, under the facts and circumstances of this case as reflected in plaintiff's testimony, Bank did not breach its duty to deal fairly with plaintiff and to communicate to her all material facts in connection with the loan transactions which Bank, as trustee, knew.

Id. at 393. *See also Benedict v. Amaducci*, No. 92 Civ. 5239 (KMW), 1993 U.S. Dist. LEXIS 3556, 1993 WL 87937, at *9 n. 10 (S.D.N.Y. Mar. 22, 1993) (trustee has duty of full disclosure regarding loan transactions).

The duty to disclose normally includes a co-trustee. A trustee, "particularly one empowered to exercise greater control, or having greater knowledge of trust affairs" is under a duty "to inform each co-trustee of all material facts relative to the administration of the trust that have come to his attention." G. Bogert, TRUSTS & TRUSTEES § 584, at 40 (Supp. rev. 2d ed. 1992). *See also Pennsylvania Co. v. Wilmington Trust Co*., 40 Del. Ch. 567, 186 A.2d 751 (Del Ch. 1962) (co-trustee has duty to keep fellow trustees informed regarding facts which would affect the price at which to sell trust property). Even though a majority of trustees are authorized to act for all trustees, each trustee is entitled to access to trust records and to information regarding the administration of the trust, including investment decisions. *See* Bogert, TRUSTS & TRUSTEES § 584, at 40. By refusing to provide a co-trustee with trust information, or a meaningful opportunity to review this information, "a co-trustee commits a breach of trust for which he may be removed as a trustee." *Id*.

A trustee has a duty to disclose all facts that may materially affect a beneficiary's interest in the trust. Therefore, generally, a trustee should disclose trust investments to beneficiaries, including loans to beneficiaries. The Restatement provides:

> [B]efore taking contemplated action, a trustee may wish to consult or to inform and invite comment from one or more of the beneficiaries. In doing so, except as otherwise authorized or directed by the terms of the trust, the trustee should select beneficiaries who appear reasonably to reflect the diverse beneficial interests that are likely to be affected and should avoid arbitrary discrimination among persons similarly situated with respect to the matter involved.
>
> In matters that can be expected to affect the trust beneficiaries generally, such as decisions establishing or altering investment policy, impartiality may call for trustees to communicate--if they do so at all--with both the trust's current beneficiary (or beneficiaries) and its primary future-interest beneficiaries. Thus, it would be ill-advised, and perhaps a breach of trust, if a trustee were to follow a regular practice of informing and consulting with the life beneficiary to the exclusion of readily available persons whose concerns and views could be fairly expected to reflect the general concerns of remainder beneficiaries.

RESTATEMENT (THIRD) OF TRUSTS, § 79.

C. Duty of Confidentiality

The duty of loyalty includes a duty to maintain the confidentiality of a beneficiary's information. The Restatement provides:

> The trustee is under a duty to the beneficiary not to disclose to a third person information which he has acquired as trustee

> where he should know that the effect of such disclosure would be detrimental to the interest of the beneficiary.

RESTATEMENT (SECOND) OF TRUSTS § 170.

The duty of confidentiality becomes more complicated when the duty comes in conflict with a duty to disclose to other beneficiaries. The Restatement addresses the conflicting position that a trustee is in when a duty to maintain the confidentiality of a beneficiary's information abuts a duty to disclose to other beneficiaries:

> Incident to the duty of loyalty, but necessarily more flexible in its application, is the trustee's duty to preserve the confidentiality and privacy of trust information from disclosure to third persons, except as required by law (e.g., rules of regulatory, supervisory, or taxing authorities) or as necessary or appropriate to proper administration of the trust. Thus, the trustee's duty of loyalty carries with it a related duty to avoid unwarranted disclosure of information acquired as trustee whenever the trustee should know that the effect of disclosure would be detrimental to possible transactions involving the trust estate or otherwise to the interests of the beneficiaries.
>
> This duty of confidentiality ordinarily does not apply to the disclosure of trust information to beneficiaries or their authorized representatives (see duties to inform and report, §§ 82 and 83) or, in the interest of one or more trust beneficiaries, to the trustees of other trusts or the fiduciaries of fiduciary estates in which a beneficiary has an interest. Even in providing information to or on behalf of beneficiaries, however, the trustee has a duty to act with sensitivity and, insofar as practical, with due regard for considerations of relevancy and sound administration, and for the personal concerns and privacy of the trust beneficiaries.

RESTATEMENT (THIRD) OF TRUSTS § 78.

When a beneficiary's information does not affect a co-beneficiary's rights, the trustee should generally maintain the information in confidence and not disclose it. However, where a beneficiary's information does impact a co-beneficiary's interest in the trust, a trustee may be in a position where a duty of loyalty requires disclosure. For example, a loan to a beneficiary may risk the loss of trust assets. Such a transaction would implicate the co-beneficiaries' rights to trust assets. In these instances, if a co-beneficiary knew of the facts, he or she would certainly have standing to seek judicial assistance in limiting the risk, i.e., forcing the trustee to not allow the loan from trust assets. So, as a general rule, a trustee should disclose loans to beneficiaries to other beneficiaries who have an interest in the trust. This, of course, may be altered by trust language, whether the trust is a revocable trust, etc.

D. Duty Of Impartiality

A trustee has a duty to treat all beneficiaries with impartiality. Texas Jurisprudence states:

> A trustee must act for all the beneficiaries; he or she may not properly act for only some of them. The trustee owes the same fiduciary duty to all to protect their respective interests, without partiality or favor to some at the expense of others; thus, a trustee is bound, in the absence of instructions to the contrary, to administer the trust

> with an eye to a remainder interest, as well as to the interest of a life tenant, and he or she cannot slight one interest for the benefit of the other. Additionally, a trustee owes the same fiduciary duty to a contingent beneficiary as to one with a vested interest, insofar as necessary for the protection of the rights of the contingent beneficiary in the trust property. This duty of impartiality has been codified in the Uniform Prudent Investor Act, which states that if a trust has two or more beneficiaries, the trustee must act impartially in investing and managing the trust assets, taking into account any differing interests of the beneficiaries.

TEX. JUR. 3RD, TRUSTS, § 64. *See also* RESTATEMENT § 183; BOGERT §§ 541, 612; *Commercial Nat. Bank of Nacogdoches v. Hayter*, 473 S.W.2d 561 (Tex. Civ. App. 1968, writ ref'd n.r.e.).

This duty requires that a trustee remain neutral in disputes that affect beneficiaries differently. As stated in *Cox-Rushing Greer Co. v. Richardson*, 277 S.W. 718, 721 (Tex. App.—Austin 1925): "Generally, a trustee owes the same fiduciary duty to a contingent beneficiary as to one with a vested interest." *See also In re K.K.W.,* No. 05-16-00795-CV, 2018 Tex. App. LEXIS 6539, at *27 (Tex. App.—Dallas Aug. 20, 2018, pet. denied); *Brown v. Scherck*, 393 S.W.2d 172, 181 (Tex. Civ. App.—Corpus Christi 1965, no writ) (citing 90 C.J.S. Trust 247, at 235); *Ahern v. Montoya*, 393 P3d 1090, 1094 (Nev. 2017) (noting "a trustee's duty to treat all beneficiaries equally" (citing *Hearst v. Ganzi*, 145 Cal App 4th 1195, 52 Cal. Rptr. 3d 473, 481 (2006))).

In *Davis v. Davis*, the trial court concluded that a trustee/beneficiary's loans to himself for $36,000, $3,000 and $25,000 were improper despite the prior authorization by the sole income beneficiary of the trust, especially where there was no evidence that the largest amount was considered a loan and part of which was only repaid over nine years later, without interest and only after persistent request for an accounting by the other remainder beneficiary. 889 N.E.2d 374 (Ind. App. 2008).

The Restatement provides:

> (1) A trustee has a duty to administer the trust in a manner that is impartial with respect to the various beneficiaries of the trust, requiring that: (a) in investing, protecting, and distributing the trust estate, and in other administrative functions, the trustee must act impartially and with due regard for the diverse beneficial interests created by the terms of the trust; and (b) in consulting and otherwise communicating with beneficiaries, the trustee must proceed in a manner that fairly reflects the diversity of their concerns and beneficial interests.
>
> (2) If a trust is created for two or more beneficiaries or purposes in succession and if the rights of any beneficiary or the expenditures for a charitable purpose are defined with reference to trust income, the trustee's duty of impartiality includes a duty to so invest and administer the trust, or to so account for principal and income, that the trust estate will produce income that is reasonably appropriate to the purposes of the trust and to the diverse present and future interests of its beneficiaries.

RESTATEMENT (THIRD) OF TRUSTS § 79. Further:

> The duty of impartiality is applicable to all duties of the trustee. Thus, the requirements of this Section are important: (1) in the making or retention of investments (see § 90); (2) in the management of real property or tangible personal property held in the trust; (3) in the allocation of receipts and expenditures between principal and income accounts (see Chapter 23), especially as fiduciary discretion, or the making of adjustments (Comment i), may be involved; (4) in decisions concerning discretionary distributions to one or more beneficiaries (see § 50); and (5) in controversies among beneficiaries concerning their rights and beneficial interests.

Id.

So, a trustee should weigh whether loaning money from the trust to one beneficiary is fair to other beneficiaries or classes of beneficiaries. Potentially, a loan to a beneficiary (as opposed to an outright distribution) may be a method to be fair to other beneficiaries. The Restatement (Third) of Trusts provides an example where a loan to a beneficiary may be a good way of ensuring impartiality between beneficiaries:

> M and F died in a plane crash while returning from a business trip together. Their wills (or revocable trusts) create a single trust for the support, health, care, and education of their three children, and also for the family of any child who might thereafter die before the trust terminates; termination is to occur as soon as no living child is under the age of 24. The concept of impartiality described in the paragraph preceding these Illustrations applies. (See also Comment e on the possible relevance of a child's independent means.)
>
> Difficult problems of judgment may be presented to the trustee in Illustration 14. These are exemplified by differences in the duration and costs of education sought by various beneficiaries; or a child may make a reasonable request for assistance in acquiring a home, or in beginning a business or profession, while the youngest child is still under age. Although the trustee may lack authority to charge these differences in educational or other benefits against different distributive shares on termination, the trustee does have discretion—instead of possibly denying an appealing but troubling request—to make loans or advances from the trust estate for all or part of the requested amount (see final paragraph of Comment d), with a lien or right of offset against the ultimate distributive share of the beneficiary or his or her issue. The trustee may also contribute suitably to the common expenses of the family of the guardian or other person by whom the children are being raised, without itemizing or directly applying funds for the beneficiaries. To the extent safely consistent with the size of the trust fund and the probable future needs of the beneficiaries, the trustee may assist those other family members financially when to do so would be in the overall best interest of the beneficiaries. In short, in the family trust in Illustration 14, the trustee has quite flexible discretion to carry out the

> probable purposes of the trust within a general duty of impartiality of the type described above.

RESTATEMENT (THIRD) OF TRUSTS § 104, Comment F, Illustration 14.

E. Conflicts of Interest

A trustee may be in a position that making a loan to a beneficiary is a conflict of interest. For example, if the beneficiary has an outstanding loan to the trustee (who may be a financial institution), and the trustee wants to make a loan to the beneficiary from the trust so that the beneficiary can use those funds to pay off the loan to the trustee in the trustee's individual capacity. This creates a conflict of interest and invokes the trustee's duty of loyalty. A trustee who is solely looking out for the beneficiary's interest may determine that it should not make the loan, that the beneficiary should default on the loan, and that the trust funds (which are likely protected by a spendthrift clause) should be used for the beneficiary's future care and maintenance.

Alternatively, a trustee, in its individual capacity, may make a loan to the beneficiary and then secure the loan with trust assets. This would create a situation where if the beneficiary defaults, the trustee will have to collect against the trust.

The Texas Bankers Association has a policy on this scenario, which states:

> Before loans are granted to a company or individual, it is the policy of the Institution to ascertain whether that company or individual borrows from the institution. If that company or individual borrows from the institution said loan shall not be made if the proceeds will be used to pay any loan to the institution.

Texas Bankers Association, Policy Manual, Section J, Policy No. 10. *Mennen v. Wilmington Trust Co.,* No. 8432-ML, 2015 Del Ch. LEXIS 122 (Ct. Ch. Del. February 13, 2015) (trustee held liable for breaches of fiduciary duty by making loans to companies to which he had personal loans); *Benedict v. Amaducci*, No. 92 Civ. 5239, 1993 U.S., Dist. LEXIS 2556 (S.D. N.Y. March 18, 1993) (injunction affirmed against a trustee for making improper loans in a self-interested transaction).

Scott on Trusts addresses the situation of a trustee, individually, loaning money to a beneficiary and then attempting to pay the loan from trust funds:

> The mere fact that a beneficiary is indebted to the trustee does not entitle the trustee to pay himself out of the beneficiary's interest in the trust property. The trustee has no charge on the trust property to secure an indebtedness of the beneficiary to him that is unconnected with the trust, and he cannot set off the indebtedness of the beneficiary to him against his obligation to pay over trust funds to the beneficiary.
>
> …
>
> Not merely is there the procedural difficulty of attempting to adjust in the probate court claims of the trustee against the beneficiary unconnected with the administration of the trust, but there is no reason why the trustee merely because he happens to be trustee should have a charge upon the trust property for a personal claim against the beneficiary. There is no reason why he should be in a better position than any other creditor. If the trust is not a spendthrift trust, the trustee, like

> any other creditor, after obtaining judgment against the beneficiary, might reach his interest by a proper judicial proceeding. Although the trustee is no better position than any other creditor of the beneficiary, he is in no worse position. If the trust is a spendthrift trust, the trustee, like any other creditor, cannot reach the interest of the beneficiary to satisfy his claim against the beneficiary.

William F. Fratcher, SCOTT ON TRUSTS, § 250 (1988). The commentator goes on to describe the trustee, individually, taking a security interest in trust property:

> The beneficiary, may, however, agree to give the trustee a charge upon his interest to secure his indebtedness to the trustee. Such an agreement may be made at the time when the indebtedness arises or subsequently. If the beneficiary is not under a legal incapacity, and if the trust is not a spendthrift trust, and if the trustee did not take an improper advantage of his position as trustee in securing the agreement the agreement is effective to give the trustee a charge upon the beneficiary's interest. Thus where the trustee out of his individual property makes an advance or loan to the beneficiary with the understanding, whether or not expressed in words, that he is to be reimbursed out of the trust estate, the trustee is entitled to repay himself out of the beneficiary's interest in the trust estate. He has a charge upon the beneficiary's interest for such advances, and if the beneficiary transfers his interest to another, the transferee takes the interest subject to the charge of the trustee for the amount of the advances.
>
> …
>
> Where the beneficiary is under a legal incapacity or where the trust is a spendthrift trust, an agreement by him to give the trustee a charge upon his interest to secure his personal indebtedness to the trustee is not binding. In such a case, the trustee is in the same position as any other creditor of the beneficiary, and is entitled to reach the beneficiary's interest to the same extent, and only to the same extent, as any other creditor could reach it.

Id.

In one case, a Texas court held that a trustee breached its fiduciary duty by making loans to the beneficiary in its individual capacity and then paying the loans off, with interest, from the trust. *See Shannon v. Frost Nat'l Bank of San Antonio*, 533 S.W.2d 389 (Tex. Civ. App.—San Antonio 1975, writ ref'd n.r.e.). The court held:

> Here, the result of the initial failure to make a full disclosure resulted in a series of loans by Bank, as a lending institution, to itself, as trustee, with both principal and interest to be paid out of funds of the trust estate. The net result, a benefit to Bank in its role as a lending institution. Stated differently, the situation is one in which the fiduciary suggested that the trust borrow from the fiduciary, and, in making such suggestion, withheld facts of which the beneficiary was ignorant. It cannot be said that, as a matter of law, under the facts and

> circumstances of this case as reflected in plaintiff's testimony, Bank did not breach its duty to deal fairly with plaintiff and to communicate to her all material facts in connection with the loan transactions, which Bank, as trustee, knew. 1 RESTATEMENT, TRUSTS 2d, § 170(2), § 173, cmt. (d) (1959).

Id. at 394.

In any circumstance, a trustee should attempt to avoid conflicts of interest. If a trustee desires to enter into a conflicted transaction, it should hire counsel to assist with measures to limit risk and obtain appropriate consent from all relevant parties.

IV. DUTY TO PROPERLY MANAGE TRUST ASSETS

A. General Authority On The Duty To Manage Trust Assets

In addition to a duty of loyalty, a trustee has a duty to manage trust assets prudently, and meeting this duty may require a trustee to make prudent decisions on investing and making loans (or securing loans). "A trustee's fundamental duties include the use of the skill and prudence which an ordinary, capable, and careful person will use in the conduct of his own affairs as well as loyalty to the trust's beneficiaries." *Herschbach v. City of Corpus Christi*, 883 S.W.2d 720, 735 (Tex. App.—Corpus Christi 1994, writ denied). Furthermore, trustees who hold themselves out as having special expertise in the area of finance and investments must use this expertise in managing their trusts. Tex. Prop. Code § 117.004 ("A trustee who has special skills or expertise, or is named trustee in reliance upon the trustee's representation that the trustee has special skills or expertise, has a duty to use those special skills or expertise."); RESTATEMENT (THIRD) OF TRUSTS § 90 cmt. d (2007) ("If the trustee possesses a degree of skill greater than that of an individual of ordinary intelligence, the trustee is liable for a loss that results from failure to make reasonably diligent use of that skill.").

"The duty of care requires the trustee to exercise reasonable effort and diligence in making and monitoring investments for the trust, with attention to the trust's objectives." RESTATEMENT (THIRD) OF TRUSTS § 90, cmt. d. "It is the duty of the trustee to exercise such care and skill to preserve the trust property as a man of ordinary prudence would exercise in dealing with his own property, and if he has greater skill than that of a man of ordinary prudence, he is under a duty to exercise such skill as he has." RESTATEMENT (SECOND) OF TRUSTS § 176(a). "It is the duty of the trustee to use reasonable care to protect the trust property from loss or damage." *Id*. § 176(b).

B. Common-Law Duty To Diversify

A trustee is a fiduciary, and courts hold them to a high standard of care in dealing with the trust property. "One of the basic duties of a trustee is to make the assets of the trust productive while at the same time preserving the assets." *Neuhaus v. Richards*, 846 S.W.2d 70 (Tex. App.—Corpus Christi 1992, no writ). "A trustee is under a duty to the beneficiary except as otherwise provided by the terms of the trust, to distribute the risk of loss by a reasonable diversification of investments, unless under the circumstances it is prudent not to do so." *Jewett v. Capital Nat'l Bank*, 618 S.W.2d 109 (Tex. Civ. App.—Waco 1981, no writ).

Restatement (Second) of Trusts § 231 (1959) states that "except as otherwise provided by the terms of the trust, if the trustee holds property which when acquired by him was a proper investment, but which thereafter becomes an investment which would not be a proper investment for the trustee to make, it becomes the duty of the trustee to the beneficiary to dispose of the property within a reasonable time." RESTATEMENT (SECOND) OF TRUSTS § 228 (1959) (recognizing that trustee has duty to diversify). Accordingly, though not precisely defined, there is generally a common-law duty to diversify in Texas unless under the circumstances it is prudent not to do so or the trust document otherwise states.

C. Statutory Duty To Diversify

1. Uniform Prudent Investor Act

The Texas Trust Code expressly adopts a trustee's common-law duties: "The 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 the trustee shall perform all of the duties imposed on trustees by the common law." Tex. Prop. Code Ann. § 113.051. Therefore, absent a contrary term in the Texas Trust Code or the trust instrument, the trustee will have a duty to diversify as per the common-law requirement.

The Texas Legislature (along with 48 other states) adopted the Uniform Prudent Investor Act effective January 1, 2004, and the Texas Trust Code now expressly discusses the concept of a duty to diversify. Subject to Chapter 117 (The Uniform Prudent Investor Act), a trustee may manage trust property and invest and reinvest in property of any character on the conditions and for the lengths of time as the trustee considers proper. Tex. Prop. Code Ann. § 113.006. Chapter 117 limits this rather broad grant of authority. It provides that a trustee who invests and manages trust assets owes a duty to the beneficiaries to comply with the prudent investor rule. Tex. Prop. Code Ann. § 117.003(a). Under the statute, the prudent investor rule provides:

> (a) A trustee shall invest and manage trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill, and caution.
>
> (b) A trustee's investment and management decisions respecting individual assets must be evaluated not in isolation but in the context of the trust portfolio as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the trust.
>
> (c) Among circumstances that a trustee shall consider in investing and managing trust assets are such of the following as are relevant to the trust or its beneficiaries: (1) general economic conditions; (2) the possible effect of inflation or deflation; (3) the expected tax consequences of investment decisions or strategies; (4) the role that each investment or course of action plays within the overall trust portfolio, which may include financial assets, interests in closely held enterprises, tangible and intangible personal property, and real property; (5) the expected total return from income and the appreciation of capital; (6) other resources of the beneficiaries; (7) needs for liquidity, regularity of income, and preservation or appreciation of capital; and (8) an asset's special relationship or special value, if any, to the purposes of the trust or to one or more of the beneficiaries.
>
> (d) A trustee shall make a reasonable effort to verify facts relevant to the investment and management of trust assets.
>
> (e) Except as otherwise provided by and subject to this subtitle, a trustee may invest in any kind of property or type of investment consistent with the standards of this chapter.
>
> (f) A trustee who has special skills or expertise, or is named

> trustee in reliance upon the trustee's representation that the trustee has special skills or expertise, has a duty to use those special skills or expertise.

Tex. Prop. Code Ann. § 117.004; *see also Barrientos v. Nava*, 94 S.W.3d 270, 282 (Tex. App.—Houston [14th Dist.] 2002, no pet.).

This duty to diversify starts as soon as the trustee takes control over the trust's assets. "Within a reasonable time after accepting a trusteeship or receiving trust assets, a trustee shall review the trust assets and make and implement decisions concerning the retention and disposition of assets, in order to bring the trust portfolio into compliance with the purposes, terms, distribution requirements, and other circumstances of the trust, and with the requirements of this chapter." Tex. Prop. Code Ann. § 117.006. *Langford v. Shamburger,* 417 S.W.2d 438, 444-45 (Tex. Civ. App.—Fort Worth 1967, writ ref'd n.r.e.) (the trustee should "put trust funds to productive use and the failure to do so within a reasonable period of time can render the trustee personally chargeable with interest."). A trustee can incur liability for not timely diversifying assets. *See, e.g., Fifth Third Bank v. Firstar Bank, N.A.*, 2006 Ohio 4506 (Ohio App. 1st Div. 2006) (trustee's plan to liquidate stock over twelve month period was too long); *Williams v. JPMorgan & Co. Inc.*, 199 F.Supp.2d 189 (S.D.N.Y. 2002) (trustee liquidated assets due to initial concern and invested in municipal bonds for thirty years).

"The recurring theme provided in case law is that in the absence of specific direction in the trust instrument, a trustee's 'reasonable determination' depends on the actual investment plan implemented and carried out by the trustee in light of the needs of the particular beneficiaries and the particular trust portfolio involved." Elliot & Bennett, *Closely Held Business Interests and the Trustee's Duty To Diversify*, TRUSTS & ESTATES, trustsandestates.com (April 2009). "This requires the trustee to develop an investment strategy tailored to the factual circumstances surrounding the trust's purpose and to evaluate the income needs of the beneficiaries. The failure to communicate with the beneficiaries or exercise any discretion at all potentially subjects the trustee to liability for failure to diversify." *Id*. The first and most important step is determining the needs of the beneficiaries. *See First Alabama Bank of Huntsville, N.A. v. Spragins*, 515 So.2d 962 (Ala. 1987).

2. "Special Circumstances" That Allow Non-Diversification

The Act does not require diversification in all circumstances. Rather, "A trustee shall diversify the investments of the trust unless the trustee reasonably determines that, because of special circumstances, the purposes of the trust are better served without diversifying." Tex. Prop. Code Ann. § 117.005. The notes to Section 117.005 of the Texas Property Code state that prudent investing ordinarily requires diversification. Tex. Prop. Code Ann. § 117.005, cmt. "Circumstances can, however, overcome the duty to diversify. For example, if a tax-sensitive trust owns an underdiversified block of low-basis securities, the tax costs of recognizing the gain may outweigh the advantages of diversifying the holding. The wish to retain a family business is another situation in which the purposes of the trust sometimes override the conventional duty to diversify." *Id. See also In re Rowe*, 712 N.Y.S2d 662 (N.Y. App. Div. 2000) (tax consequences); RESTATEMENT (THIRD) TRUSTS, § 227 (1992). The Restatement provides similar language:

> [T]he trustee's decision to retain or dispose of certain assets may properly be influenced, even without trust terms expressly bearing on the decision, by the property's special relationship to some objective of the settlor that may be inferred from the circumstances, or by some special interest or value the property may have as a part of the trust estate … Examples of such property might be land used in a family farming operation, the assets or shares of

> a family business, or stockholdings that represent or influence control of a closely or publically held corporation.

RESTATEMENT (THIRD) TRUSTS, § 92 (1992).

These examples are not the only circumstances and are not intended to be all-inclusive. Other circumstances may include: personal property with a special attachment by the settlor or beneficiaries; maintaining a farm or ranch property; maintaining residential or vacation property; life insurance policies; stock in a company where the settlor had long-term employment or other special relationship; commercial real property where the settlor had long-term special relationship; special purpose trusts; and assets that are difficult to sell. Trent S. Kiziah, *The Trustee's Duty to Diversify: An Examination of The Developing Caselaw*, 36 ACTEC L. J. 357, 370-78 (2010).

D. Conclusion on the Duty to Properly Manage Assets

A trustee has a fiduciary duty to properly manage trust assets. That includes making investments that are reasonably safe and are consistent with a plan that includes proper diversification. Some regulators take the position that proper diversification means that any one asset should not be any more than twenty percent of the trust's assets. Some global corporate trustees take the position that an asset should not generally be more than five percent of the total assets. For example, one court held that a trustee breached his fiduciary duty by having a loan constitute twelve percent (12%) of the assets. *Donovan v. Mazzola*, 2 E.B.C. 2115 (N.D. Cal. 1981), *aff'd* 716 F.2d 1226 (9th Cir. 1983). *See also Estate of Milton Samuels*, 1994 NYLJ LEXIS 277 (Sur. Ct. N.Y June 29, 1994) (trustee breached duty and was surcharged with loss associated with unsecured loan to individual that violated diversification standards); *Brock v. Citizens Bank of Clovis*, No. Civ. 83-1054, 1985 U.S. Dist. LEXIS 12482, 1985 WL 71535 (D.N.M. Dec. 20, 1985), *aff'd*, 841 F.2d 344 (10th Cir. 1988) (concentration in mortgage loans violated diversification requirements). *But see In re Estate Of Nuese*, 25 N.J. Super. 406 (N.J. C.C. Apr. 2, 1953) (trustee did not violate duty to diversify by having multiple mortgage loans: "While about two-thirds of the corpus of the trust was invested in mortgage loans, there is no indication that the loans were not reasonably diversified. The mortgages covered many properties in various parts of New York City and with few exceptions were in relatively small amounts.").

As stated above, there are exceptions to diversification where a trustee can reasonably have a concentration. One could imagine a circumstance where the trustee acts to support the purpose of a trust (to care for a beneficiary) by making a loan from the trust to the beneficiary that may justify a trustee having a concentration via the loan. In the end, the trustee should be aware of its duty to properly manage trust investments and the duty to diversify and factor those duties in determining whether the trust should make the loan, the terms of the loan, and whether it should be secured.

V. CONSIDERATIONS/DUE DILIGENCE IN MAKING LOANS

When a trustee decides to make a loan to a beneficiary, it should be careful to properly document the loan and to conduct appropriate due diligence. As one commentator has stated:

> A trustee should not usually make loans of trust assets without sufficient collateral, but some trusts are drafted specifically in contemplation of loans being made to some or all of the beneficiaries. However, fixed income investments, such as commercial paper, that represent unsecured loans to the issuer's creditors, may be appropriate under the applicable Prudent Investor Rule and should expressly be included in the document's general clause conferring investment management authority on the trustee.

> Loans to beneficiaries may present special challenges of collectibility, and they should be documented meticulously. If secured or unsecured loans are anticipated to family members, the trust instrument should specifically provide for them, including without limitation guidance on the purpose for which such a loan may be made, the interest rate that should be charged, whether or not security should be required, the duration of such a loan, handling of defaults, and whether any such loans constitute an advancement. This may be a dangerous practice in trusts that do not specifically authorize loans to beneficiaries, since uneven lending among the beneficiaries may result in claims that the trustee has violated its duty of impartiality.

1 TRUST DEPARTMENT ADMINISTRATION AND OPERATIONS § 4.04(1)(D)(vi).

Regarding unsecured loans, another commentator states:

> Before the enactment of the Uniform Prudent Investor Act, trustees in Texas did not have the power to make unsecured loans, unless the trust agreement explicitly gave the trustee such a power. *See Levin v. Commissioner of Internal Revenue*, 355 F2d 987, 990-91 (5th Cir 1966) (payments to beneficiary were taxable as distributions, because trust instrument did not give trustee the authority to make unsecured loans of trust corpus); *see also* Tex. Prop. Code § 113.052(b)(1) (self-dealing statute implies that loans to beneficiaries are prohibited unless explicitly authorized by the trust instrument); *but see* RESTATEMENT (SECOND), TRUSTS § 227, cmt. (i) (noting that some unsecured loans, such as savings accounts at banks, may be proper) (replaced in Third Restatement by the prudent investor rule, which makes no mention of security for loans).
>
> If the trust instrument authorizes the trustee to invade corpus for the benefit of the beneficiary, this authority will include the ability to make unsecured loans of corpus to the beneficiary. *Beaty v. Bales*, 677 SW2d 750, 757 (Tex. App.—San Antonio 1984, writ ref'd n.r.e.) (trustee made unsecured loan to trustee's sister, who was a beneficiary).
>
> However, the Uniform Prudent Investor Act, which took effect in Texas on January 1, 2004, eliminated all categorical prohibitions on trust investments. *See* Tex. Prop. Code § 117.004(e). Arguably, this elimination applies to common law prohibitions as well as statutory ones. Although the Act does not mention unsecured loans, the Act's emphasis on looking at total return instead of individual investments is not consistent with a ban on unsecured loans. Thus, trustees may now have the power to make unsecured loans.
>
> The need to make unsecured loans has become an issue because of the complexities of modern investing and the modern use of trusts. If a settlor is funding a revocable inter

> vivos trust of which he intends to serve as sole trustee, he may expect to be able to lend without security the money that he considers to be his own. Given the current ambiguity in Texas law, it may still be prudent to include specific authorization in the trust document.

Texas Estate Planning § 20:97.

Furthermore, American Jurisprudence states:

> Unsecured loans or loans secured only by a prospective or contingent interest in the trust res cannot properly be made to beneficiaries of the trust, at least where they are not entitled to receive any part of the income or principal, except an annuity, until the termination of the trust. An unsecured loan to a beneficiary is not justified because it is made to enable him or her to pay taxes on income that he or she receives from the trust, even though a trustor may not have anticipated such a tax, and the tax reduces net sums available to the beneficiary, at least where a proper construction of the trust instrument leads to the conclusion that the trustor intended primarily a particular distribution of his or her estate, although including annual payments to the beneficiary, rather than primarily the provision for the maintenance, support, and education of the beneficiary. However, there is no absolute rule that trustees must accept collateral security in addition to personal security in lending trust assets.

76 AM. JUR. 2d, Trusts § 450

A reasonable lender should do certain due diligence in making a loan to minimize the lender's risk. A lender should do due diligence to ensure that a borrower can repay the loan. It should obtain a borrower's financial statements and federal tax returns. Generally, lenders request to see proof of employment, such as recent pay stubs or W-2 forms, to verify income. Additional documentation that lenders request might include federal tax returns for at least the last two years, bank statements for the last three months, and balance sheets if the borrower is self-employed. Lenders rate a borrower's creditworthiness by looking at assets, amount of debt owed, and timely bill payments.

A lender should generally attempt to obtain security for a loan. As one court stated: "a trustee of a conventional trust, whose chief duty is to safeguard and expand the trust res for the benefit of income beneficiaries and remainder interests, should either accept sufficient collateral security when making a loan of trust assets or "be prepared to show that the borrower was, at the time [of the loan], possessed of property, and in good credit, and that [the trustee] has taken [personal] security in the names of persons of like standing." *Bartlett v. Dumaine*, 128 N.H. 497, 501, 523 A.2d 1 (1986).

The trustee/lender should execute a note and a separate security agreement or deed of trust to secure collateral and provide lien on the security. If the transaction is consummated, the trustee/lender should be careful to perfect the lien. What is required to perfect a lien will vary depending on the type of collateral. The amount of security should be sufficient to repay the loan in full if there is ever a default and the lender has to foreclose on the security.

A lender should generally attempt to obtain a guaranty agreement from other parties to protect the lender from the risk of default.

The loan's interest rate should reflect the risk involved in the loan. The riskier the loan, the higher the interest rate. The trustee/lender should do due diligence to determine what a reasonable lender would charge for a similar loan with similar terms. This could mean internet research and conversations with other lenders. The trustee should document his or her file with the results of this due diligence.

The Texas Bankers Association has a policy on a trustee making a loan other than a real estate loan:

> It is the policy of the Institution to consider the following when making any loans, other than real estate loans: (a) the characteristics of the loan being made; (b) the amount of investing in non-real estate loans; (c) appropriate documentation; (d) the prohibitions of 12 U.S.C. § 92a(h) regarding loans to institution directors, officers or employees; (e) requirements of the Employee Retirement Income Security Act of 1974 (ERISA) and other laws applicable to loans from employee benefit accounts; (f) acceptability and marketability of collateral; (g) collateral value to loan to ratio; (h) UCC registration of liens; (i) creditworthiness of the borrower and any endorsers or guarantors; (j) probability of loan collection without liquidation of collateral; (k) possibility of distributing the loan to a beneficiary if the loan is made to that party. It also is the policy of the Institution to maintain prescribed procedures for follow-up of past due loans.

Texas Bankers Association, Policy Manual, Section G.5, Policy No. 9.

If the loan is going to be a real estate loan, a lender should require a copy of the purchase contract, which includes a legal description of the property and of the type of deed the seller will convey. The contract should also outline the land, buildings and personal property that are included in the sale, noting any easements or restrictions on the use of the property. Because the real estate serves as collateral to secure the loan, a lender will require title insurance issued by a title company. A lender's title insurance policy protects the lender against lawsuits or claims relating to ownership. Title examination is a review of public records relating to the ownership history of the property. A title search also identifies any liens, judgments or unpaid property taxes. The lender should obtain an appraisal report of the property/collateral to ensure that the value of the collateral is sufficient to repay the loan in the event that the lender has to foreclose on the property. The lender should also require that the borrower maintain adequate insurance on the real property to protect its interest in the collateral. The lender should require the borrower to regularly forward documents to make sure that the borrower complies with the insurance requirement.

The Texas Bankers Association has a policy on a trust making a real estate loan:

> Real estate loans include mortgages, purchase money mortgages, real estate notes secured by deeds of trust, and contracts of sale. It is the policy of the Institution when making investment decisions about real estate loans to consider: (a) real estate values based on appraisals by competent appraisers; (b) prudent ratio of loan to appraised value of real estate security; (c) borrower's ability to pay; (d) compliance with law and regulation; (e) documentation necessary to establish priority of lien, nd legality and validity of loan; (f) appropriateness of types of amounts of insurance; and (g) adequacy of interest rates charged. Real estate loans shall be approved by a committee or authorized person. It also is policy to require that current real estate appraisals be

> obtained for property securing the loan upon extension of maturity or other modifications of such loans. If a loan is secured by real estate in another state, it is the policy of the Institution to determine that it, as fiduciary, can enforce foreclosure. Unless specifically authorized, it is the policy of the institution not to permit the institution to make real estate mortgage loans and then sell them to various trust department accounts, unless the loans were earmarked at inception for this ultimate purpose.

Texas Bankers Association, Policy Manual, Section G.3, Policy No. 1.

It also provides what type of documentation that a trustee should maintain regarding a real estate loan:

> It is the policy of the Institution that the loan file on each mortgage or deed of trust note contain the following records: (a) a copy of the note and deed of trust securing the note; (b) an appraisal of the property; (c) a title insurance policy covering the property; (d) adequate insurance coverage such as fire and extended coverage and liability. All policies should contain a mortgagee clause which will protect the mortgagee's interest in case the fire of other mishap; (e) a loan amortization schedule of principal and income repayment; (f) copies of real estate tax bills; and (g) correspondence relating to the property and the loan. Where notes originated with other institutions such as through acquisitions, the documentation above will be obtained to the extent possible.

Texas Bankers Association, Policy Manual, Section G.3, Policy No. 2.

Generally, a trustee should treat a loan to a beneficiary as a loan to any other third party and should conduct due diligence to make sure that the beneficiary can repay the loan, the loan's terms are reasonable, the loan is secured, and there could be guarantees from others.

VI. TRUST LOANS AS DISTRIBUTIONS

There is an exception to the general advice stated in the prior section on due diligence and security. Because a loan to a beneficiary is inherently different from a loan to a third party, a trustee should consider whether the loan is more akin to a distribution. The Restatement provides:

> Sometimes a beneficiary requests funds for a purpose that falls within the reasonable discretion of the trustee but which the applicable standard would not require the trustee to furnish. If the trustee is reluctant for some reason to make the requested distribution, and particularly if the trustee's concern is one of impartiality, the trustee has discretion to make a loan or advance to the beneficiary. The loan need not qualify as a prudent investment under § 90. RESTATEMENT THIRD, TRUSTS (Prudent Investor Rule) § 227. It is a form of discretionary benefit, and may be made at a market rate of interest or at low or no interest; and funds may be advanced with recourse only against the beneficiary's interest, without personal liability. *See also* Comment f, final paragraph.

RESTATEMENT (THIRD) TRUSTS, § 50, cmt. d(6).

For example, *In re Anne Hamilton Killian Trust for Benefit of Hunter,* 519 N.W.2d 409, 411 (Iowa Ct. App. 1994), the court affirmed a trustee's loan to a beneficiary for home repair where the trust allowed distributions for the beneficiary's lifestyle. The court stated:

> Based on the language used in the trust itself, the trustee has broad discretion in using the funds to support and maintain the beneficiaries. The intent to maintain a certain lifestyle and to provide housing is clear. We conclude from the language creating the trust the trustee could have used all of the income and whatever principal was needed for these purposes. We do not find repairs to a beneficiary's home outside the uses for which the trustee was directed to use the trust. The trustee made the discretionary decision not to use the income and principal but rather to make the loans. This approach could accomplish both the objectives of providing for the immediate beneficiary yet preserving the trust corpus for future beneficiaries. Applying the prudent person standard to the trustee's actions, however, we agree with the district court the loans should have been secured. We affirm the court's decision requiring the trustee to secure the loans before approval is given for the annual reports. This equitable remedy meets the needs of the interested parties without being excessively burdensome.

Id. at 413-14.

Some statutes expressly state that trustees can make loans to beneficiaries on less than commercially reasonable terms. For example, North Carolina General Statute § 36C-8-816(18) permits a trustee to "[m]ake loans out of trust property, including loans to a beneficiary on terms and conditions the trustee considers to be fair and reasonable under the circumstances . . . ." The comments to the statute clarify that "[t]he determination of what is fair and reasonable must be made in light of the fiduciary duties of the trustee and purposes of the trust." *Id*. (comment to paragraphs 18 and 19). In addition, the comments recognize that "[f]requently, a trustee will make loans to a beneficiary which might be considered less than prudent in an ordinary commercial sense although of great benefit to the beneficiary . . . ." *Id*. But, a court can still find that a trustee breaches a fiduciary duty by making an unreasonable loan to a beneficiary depending on the facts and circumstances of the case. *Ballard v. Combis*, No. 16-2057, 759 Fed. Appx. 152, 2019 U.S. App. LEXIS 526, n. 6 (4th Cir. Jan. 8, 2019).

Further, a trustee may treat a defaulted loan as a distribution if the trust language so allows. For example, in *Sommer v. Garrett*, a trustee loaned an amount from the trust to a beneficiary that equated to the beneficiary's interest in the trust. No. A-1-CA-35753, 2018 N.M. App. Unpub. LEXIS 193 (Ct. App. N.M. June 28, 2018). When the beneficiary defaulted, the trustee treated the loan as a distribution and informed the beneficiary that he no longer had any interest in the trust. Then beneficiary challenged that decision and argued that the loan was improper and that he was still a beneficiary of the trust.

The trust stated: "Trustee, in … Trustee's absolute discretion may supplement same out of principal of each beneficiary's Trust to such extent and in such manner as . . . Trustee deems necessary or appropriate for such purposes. Distribution of the entire principal of each beneficiary's Trust is authorized if . . . Trustee determines such distribution to be in the best interest of the beneficiary thereof in accordance with the foregoing standard." *Id*. The court held that this provision allowed the trustee to make a loan to the beneficiary. The court also held that the Restatement did not specifically prohibit a loan from being treated as a distribution if the loan is not repaid in the manner agreed upon. *Id.* (citing RESTATEMENT (SECOND) OF TRUSTS § 255). The court affirmed the trustee's actions.

Accordingly, depending on the trust language and other factors, a trustee may make a loan to a beneficiary on less than commercially reasonable terms and, if a default occurs, may treat the loan as a distribution.

VII. TAX IMPLICATIONS

It should be noted that tax advice is outside the scope of this article. In general, if a beneficiary has the cancellation of debt income because the debt is canceled, forgiven, or discharged for less than the amount the beneficiary must pay, the amount of the canceled debt is taxable and the beneficiary must report the canceled debt on his or her tax return for the year the cancellation occurs. The canceled debt is not taxable, however, if the law specifically allows a person to exclude it from gross income.

After a debt is canceled, the creditor/trustee may send a Form 1099-C, Cancellation of Debt showing the amount of cancellation of debt and the date of cancellation, among other things. However, a beneficiary's responsibility to report the taxable amount of canceled debt as income on his or her tax return for the year when the cancellation occurs does not change whether or not he or she receives a correct Form 1099-C.

In general, a beneficiary must report any taxable amount of a canceled debt as ordinary income from the cancellation of debt on Form 1040, U.S. Individual Income Tax Return, Form 1040-SR, U.S. Tax Return for Seniors or Form 1040-NR, U.S. Nonresident Alien Income Tax Return as "other income" if the debt is a nonbusiness debt, or on an applicable schedule if the debt is a business debt. For more on this subject, a party should consult an accountant and/or review https://www.irs.gov/taxtopics/tc431.

Moreover, "loans" on less than commercially reasonable terms may be considered distributions and there may be a requirement to report them as income. This may also impact GST considerations.

VIII. TRUSTEE SHOULD CONTRACTUALLY EXTEND STATUTE OF LIMITATIONS

A trustee never wants to sue a beneficiary for breaching a loan agreement. The trustee should attempt to work out the nonpayment issues as long as it can. However, at some point, the trustee will push against the statute of limitations period and may be forced to sue the beneficiary. A trustee may want to consider adding a provision in the note and security agreement that extends the statute of limitations for suits to collect on the note.

In *Godoy v. Wells Fargo Bank, N.A.*, a bank sued a guarantor to recover on a deficiency following a foreclosure sale. 575 S.W.3d 531 (Tex. 2019). The defendant guarantor alleged that any such claim was barred by the two-year statute of limitations. The lender argued that the statute-of-limitations defense had been waived by provisions in the loan documents. The guarantor argued that a statute-of-limitations defense can only be waived if the language in the waiver is specific and for a defined period of time, and claimed that the waiver was indefinite and void as against public policy because it allowed the lender to bring suit at any time in the future. The lender argued that, by signing a broad waiver of all defenses, a party can waive all statute-of-limitations defenses indefinitely.

Regarding waivers of a statute of limitations defense, the Texas Supreme Court held:

> In *Simpson v. McDonald*, we stated: "It appears to be well settled that an agreement in advance to waive or not plead the statutes of limitation is void as against public policy." Since Simpson was decided, courts of appeals have built upon its holding to require that a waiver of a statute of limitations is void unless the waiver is "specific and for a reasonable time."

> Indeed, the requirement that in order to be enforceable the statute-of-limitations waiver must be "specific" and "only for a reasonable time" was already understood to be part of the law at the time Simpson was decided.… Blanket pre-dispute waivers of all statutes of limitation are unenforceable, but waivers of a particular limitations period for a defined and reasonable amount of time may be enforced.

Id. The Court ruled that the clause in the case was sufficiently specific and was for a reasonable time and ruled for the lender.

Once again, a trustee never wants to sue its beneficiary for any reason, and delay is often present in these circumstances. For example, recently, a court of appeals held that the statute of limitations did not apply to bar a trustee's claim on a promissory note under the facts of that case. *DeRoeck v. DHM Ventures, LLC,* 576 S.W.3d 875 (Tex. App.—Austin 2019, no pet.). The *Godoy* opinion arms a trustee with one more tool. A trustee can have the note, guaranty agreement, or other similar document expressly state that the borrower waives the defense of the statute of limitations for a certain period of time (negotiable notes have a six year statute of limitations in Texas, and potentially, a waiver clause could extend that to eight years).

IX. TRUSTS SECURING LOANS FROM THIRD PARTIES FOR BENEFICIARIES

Instead of a loan from a trust to a beneficiary, a beneficiary may request that the trust agree to guarantee or secure a loan from a third party. A trustee generally has authority to encumber trust assets:

> Unless prohibited by statute or the terms of the trust, a trustee has power to borrow money for trust purposes and to pledge, mortgage, grant a deed of trust, or otherwise encumber trust property. The trustee has a duty to exercise caution as well as the duty to exercise care and skill in deciding whether and under what terms to borrow money for trust purposes or to grant a security interest in trust property.
>
> …
>
> Because of a trustee's duty to respect the terms of the trust (§ 76), it is normally improper for a trustee to exercise the power to encumber trust property by granting security interests in assets that are to be specifically distributed to one or more beneficiaries on termination.

RESTATEMENT (THIRD) OF TRUSTS, § 86.

Once again, a trustee should review the trust agreement. There are potential trust provisions that expressly allow a trustee to provide security for loans to beneficiaries. One example is as follows:

> The trustee, in the trustee's discretion, is authorized to endorse, guarantee, become the surety of or otherwise become obligated for or with respect to the debts or other obligations of any person (including a beneficiary), firm, corporation, partnership, trust or other legal entity, whether with or without consideration, when the trustee believes such actions advance the purposes of any trust created or continued hereunder.

Where a trust document allows such a transaction, a trustee may generally enter into such an agreement where it is done in good faith.

For example, in one case, the trust granted the trustee the power: "to lend money to any beneficiary hereunder, either with or without security and on such other terms as my executors may deem appropriate." *In re Hanes*, 214 B.R. 786, 822 (Bankr. E.D. Va. 1997). The court construed this language as: "The language of the above provisions expressly permits lending to the beneficiaries and the pledging of any assets to secure borrowing." *Id*. It held that the challenged loans were permissible:

> Viewing the instruments and the circumstances as a whole, we find that it was Hanes, Sr.'s intention to give his sons broad authority to manage the Marital Trust in their absolute discretion. The family investment plan was a proper function of Hanes duties as Trustee. To the extent that the DCI Companies were investments made by HILP in furtherance of the family investment plan, the pledges securing lending directly to these entities was authorized.

Id.

In the absence of trust language, there is general statutory authority that may allow this type of transaction. A trustee has the general power to do anything that is necessary or appropriate to carry out the purpose of the trust. Tex. Prop. Code Ann. § 113.002. There is also a specific statute that addresses encumbering trust assets:

> *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*.

Tex. Prop. Code § 113.015 (emphasis added). This statute allows a trustee to encumber trust assets (allow them to be collateral for a loan) if the trustee finds that the lien would be advantageous for the administration of the trust. Note that this does not require the trustee to find that it is a good investment or that encumbering the assets are for consideration. Rather, a trustee may find, for example, that benefiting a beneficiary by agreeing to such a lien may be advantageous to the administration of the trust where the trust is for the primary benefit of the beneficiary and agreeing to the lien is better than making a distribution or a loan.

Other states have similar statutes that allow a trustee to secure loan for the benefit of a beneficiary. *See, e.g.*, Oregon Rev. Stat. 130.725 (2017) (A trustee may "[p]ledge trust property to guarantee loans made by others to the beneficiary.").

A third party lender will likely want to make sure that the trustee has the authority to encumber trust assets and may seek a copy of the trust document. When a trustee wants to enter into a transaction to secure a loan for a beneficiary, it may want to provide a certification of trust instead of providing an entire trust document. Texas Property Code Section 114.086 provides:

> [T]he trustee may provide to the person a certification of trust containing the following information: (1) a statement that the trust exists and the date the trust instrument was executed; (2) the identity of the settlor; (3) the identity and mailing address of the currently acting trustee; (4) one or more powers of the trustee or a statement that the trust powers include at least all the powers granted a trustee by Subchapter A, Chapter 113; (5) the revocability or irrevocability of the trust and the identity of any person holding a power to revoke the trust; (6) the authority of cotrustees to sign or otherwise authenticate and whether all or less than all of the

cotrustees are required in order to exercise powers of the trustee; and (7) the manner in which title to trust property should be taken.

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

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

(d) A certification of trust: (1) is not required to contain the dispositive terms of a trust; and (2) may contain information in addition to the information required by Subsection (a).

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

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

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

(h) A person who in good faith enters into a transaction relying on a certification of trust may enforce the transaction against the trust property as if the representations contained in the certification are correct. This section does not create an implication that a person is liable for acting in reliance on a certification of trust that fails to contain all the information required by Subsection (a). A person's failure to demand a certification of trust does not: (1) affect the protection provided to the person by Section 114.081; or (2) create an inference as to whether the person has acted in good faith.

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

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

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

Tex. Prop. Code § 114.086.

X. TRUSTS' CLAIMS AGAINST BENEFICIARIES

If a trustee makes a loan to a beneficiary, the trustee should be prepared to collect on the loan if the beneficiary defaults. This may mean suing the beneficiary.

The Texas Bankers Association has a policy on past due loans:

> It is the policy of the Institution to employ the following procedures for past due loans: (a) a follow-up program of collection; (b) periodic reporting of delinquencies to the Trust Committee; (c) inspecting the property with a view toward forestalling a deterioration of the premises, and the consequent preservation of sale value and marketability of the property if foreclosure appear necessary; and (d) observing the statute of limitations to preserve collectability.

Texas Bankers Association, Policy Manual, Section G.3, Policy No. 4.

If the beneficiary causes harm to the trust due to his or her activities, a trustee may have a claim against the beneficiary. Texas Property Code Section 114.031 provides:

> A beneficiary is liable for loss to the trust if the beneficiary has: (1) misappropriated or otherwise wrongfully dealt with the trust property; (2) expressly consented to, participated in, or agreed with the trustee to be liable for a breach of trust committed by the trustee; (3) failed to repay an advance or loan of trust funds; (4) failed to repay a distribution or disbursement from the trust in excess of that to which the beneficiary is entitled; or (5) breached a contract to pay money or deliver property to the trustee to be held by the trustee as part of the trust.

Tex. Prop. Code § 114.031(a). So, if a beneficiary has caused loss to the trust due to wrongfully dealing with trust property, a trustee has a claim against the beneficiary, who is liable for the loss. *Id*.

One important issue is that the beneficiary may not have any assets, so suing the beneficiary may be a worthless exercise. The Texas Property Code also has a provision that allows a trustee to offset any distributions to the beneficiary due to a loss:

> Unless the terms of the trust provide otherwise, the trustee is authorized to offset a liability of the beneficiary to the trust estate against the beneficiary's interest in the trust estate, regardless of a spendthrift provision in the trust.

Tex. Prop. Code § 114.031(b). Therefore, if a trustee establishes a claim against the beneficiary, the trustee can then simply payoff that debt by offsetting distributions otherwise due to the beneficiary from the trust. A statute of limitations might bar a lawsuit against the beneficiary, but there is recourse to the beneficiary's interest in the trust. *See, e.g., Cook v. Cook*, 177 Cal.App.4th 1436, 99 Cal. Rptr.3d 913, 918-919 (2009) (allowing recourse, despite the running of the statute of limitations, because the settlor "expressed intent to offset unpaid debts to implement a testamentary plan to treat each beneficiary equally").

The Restatement (Third) of Trusts provides:

> (1) A beneficiary is not personally liable to the trust except to the extent: (a) of a loan or advance to the beneficiary from the trust; (b) of the beneficiary's debt to the settlor that has been placed in

> the trust, unless the settlor manifested a contrary intention; (c) the trust suffered a loss resulting from a breach of trust in which the beneficiary participated; or (d) provided by other law, such as the law of contract, tort, or unjust enrichment.
>
> (2) If a beneficiary is personally liable to the trust, the trust is entitled to a charge against the beneficiary's interest in the trust to secure the payment of the liability.

RESTATEMENT (THIRD) OF TRUSTS, § 104. The comments state:

> If the trustee makes a loan or advance of trust property to a beneficiary, the beneficiary ordinarily is personally liable to the trust for the unrepaid amount of the loan or advance. The nature and extent of the obligation, however, may be affected by the terms of the trust

Id. cmt. (d). It further provides:

> If a beneficiary is personally liable to the trust, the trust is entitled, as stated in Subsection (2), to a charge against the beneficiary's interest in the trust to secure the payment of the liability. This rule applies even though the beneficiary's interest is subject to a spendthrift restraint.

Id. cmt. (h).

Similarly, Scott on Trusts provides:

> Where a beneficiary is under a liability to pay money into the trust estate, his interest in the trust estate is subject to a charge for the amount of his liability. This is an application of a broader principle that "a person entitled to participate in a fund and also bound to contribute to the same fund cannot receive the benefit without discharging the obligation." This broad principle that he who seeks equity must do equity.

William F. Fratcher, SCOTT ON TRUSTS, § 251 (1988). The commentator continues:

> If the trustee makes a loan of trust money to one of the beneficiaries, not only is the beneficiary personally liable to the repay the amount of the loan to the trust, but his interest is subject to a charge for the amount lent. The rule is the same where the trustee makes an advance out of the trust estate to the beneficiary, that is, a payment to the beneficiary before the time when by the terms of the trust the payment is due. Where the payment is made by way of loan, the beneficiary expressly undertakes to repay the amount of the loan to the trust; and even if there is no agreement that his interest in the trust is security for the loan, the trustee may nevertheless withhold payments otherwise due to him in order to reimburse the trust estate for the amount of the loan. Where the trustee makes an advance out of the trust estate to the beneficiary, the beneficiary is personally liable, even though he has not expressly agreed to repay the amount of the advance. Where the trustee makes a loan or advance to a beneficiary out of the trust property, his interest in the trust is subject to a charge for the

> amount lent to advanced, and the trustee in order to reimburse the estate can withhold what would otherwise be payable to the beneficiary.

Id. § 255.

Furthermore, the fact that a trust may be a spendthrift trust does not protect a beneficiary from a trustee offsetting future distributions by what is owed. *See Bruce G. Robert QTIP Marital Trust v. Grasso*, 332 S.W.3d 248 (Ct. App. Mo. December 28, 2010) (citing RESTATEMENT (SECOND) TRUSTS, §225(f): "Spendthrift trust. Although the interest of the beneficiary is not transferable by him or subject to the claims of his creditors, his interest is subject to a charge for advances made to him out of the trust property unless the settlor has manifested a different intention."); *Danning v. Lederer*, 232 F.2d 610, 614 (7th Cir. 1956) (the existence of a provision allowing the beneficiary to receive loans from the trust does not to invalidate the spendthrift clause).

These rights may not practically be relevant if the only beneficiary of the trust is the beneficiary who has defaulted on the loan and caused the loss. However, where the trust has multiple beneficiaries (including contingent remainder beneficiaries), these rights are important to allow a trustee to treat all beneficiaries fairly, which it has a fiduciary duty to do.

XI. TRUSTEE LIABILITY FOR FAILING TO PURSUE DEFAULTED LOANS

A. Trustee Has A Duty To Properly Manage Trust Assets

Once again, "A trustee's fundamental duties include the use of the skill and prudence which an ordinary, capable, and careful person will use in the conduct of his own affairs as well as loyalty to the trust's beneficiaries." *Herschbach*, 883 S.W.2d at 735. "The duty of care requires the trustee to exercise reasonable effort and diligence in making and monitoring investments for the trust, with attention to the trust's objectives." RESTATEMENT (THIRD) OF TRUSTS § 90 cmt. d (2007). "It is the duty of the trustee to exercise such care and skill to preserve the trust property as a man of ordinary prudence would exercise in dealing with his own property, and if he has greater skill than that of a man of ordinary prudence, he is under a duty to exercise such skill as he has." RESTATEMENT (SECOND) OF TRUSTS §176(a). "It is the duty of the trustee to use reasonable care to protect the trust property from loss or damage." *Id*. § 176(b).

A trustee has a duty to properly manage trust assets, including debt instruments. If a borrower defaults on a loan from the trust, the trustee should consider whether it should sue the borrower to collect on the loan.

B. Trustee Has Discretion To Pursue Litigation

The Texas Trust Code provides: "A trustee may compromise, contest, arbitrate, or settle claims of or against the trust estate or the trustee." Tex. Prop. Code § 113.019. Trusts often have a similar provison, such as "the trustee has the power to commence, compromise, settle, arbitrate, or defend at the expense of the Trust any litigation with respect to the Trust as the Trustee deems necessary or advisable." *DeRouen v. Bryan*, No. 03-11-00421-CV, 2012 Tex. App. LEXIS 8635 (Tex. App.—Austin Oct. 12, 2012, no pet.). One court has held that under the Texas Trust Code and the terms of the trust, that a trustee is authorized, but not required, to pursue litigation against a debtor. "Absent bad faith or an abuse of discretion, Bryan cannot be held liable for his refusing to do so." *Id*. (citing *Corpus Christi Bank & Trust v. Roberts*, 597 S.W.2d 752, 754 (Tex. 1980) (explaining that trustee's authority under Texas Trust Act and terms of trust was discretionary and subject to review only for abuse of discretion); *see also* Tex. Prop. Code Ann. § 113.051 ("The trustee shall administer the trust in good faith according to its terms and [the Texas Trust Code]."")). The *DeRouen* case dealt with a beneficiary suing a trustee for failing to sue the beneficiary's ex-wife for improperly receiving trust distributions. *Id*. The court of appeals affirmed summary judgment for the trustee. *Id*. The court stated:

DeRouen does not contend, either in his response to the motion for summary judgment or now in this appeal, that Bryan's decision not to pursue litigation was in bad faith or an abuse of discretion. Further, the summary-judgment record in this case would not support such a finding. In response to Bryan's motion for summary judgment, DeRouen included his affidavit as summary-judgment evidence. In relevant part, DeRouen states in his affidavit:

In December 2009, Bryan finally agreed to meet with me in person. Bryan acknowledged that the Trust funds had been improperly disbursed to a non-beneficiary. Bryan admitted that the first withdrawal had been made solely in response to a telephone call from Angela DeRouen. I shared with Bryan the other actions that Angela DeRouen had secretly taken and the horrible financial problems she caused me. I asked Bryan to take legal action on behalf of the Trust to recover the Trust funds he had improperly disbursed. Bryan stated that he would consider doing so and the meeting ended.

While this constitutes evidence that Bryan refused to take legal action to recover the funds, it fails to raise a fact issue with regard to whether Bryan acted in bad faith or abused his discretion in doing so. *See Caldwell v. River Oaks Trust Co*., No. 01-94-00273-CV, 1996 Tex. App. LEXIS 1798, at *12 (Tex. App.—Houston [1st Dist.] May 2, 1996, writ denied) (mem. op., not designated for publication) (noting that power "is considered discretionary if the trustee may decide whether to exercise it or not" and that summary-judgment evidence reflected that trustee's decision was "neither arbitrary nor capricious"). Instead, Bryan's deposition testimony, also attached to DeRouen's response to the motion for summary judgment, was that Bryan made the decision not to pursue litigation against Angela after considering the advice of counsel, his discussions with the trustor, and the potential cost of the litigation. Because there is no evidence that Bryan acted in bad faith or abused his discretion, the trial court did not err in granting summary judgment on DeRouen's breach-of-fiduciary duty claim and breach-of-contract claim based on Bryan's refusal to take legal action.

[]Smilarly, there is no evidence to support DeRouen's claims based on Bryan's refusal to pursue litigation to recover the funds. Consequently, the trial court did not err in granting summary judgment on DeRouen's claims for breach of fiduciary duty and breach of contract.

Id. at *12-14.

A trustee does not always need to pursue every potential claim. In determining whether to sue a party, a trustee should weigh the likelihood of success, the amount of damages, the ability of defendant to pay, and the expense of the suit. For example, a trustee does not need to pursue collection efforts if the beneficiary cannot repay the loan. The Texas Trust Code states: "A trustee may abandon property the trustee considers burdensome or worthless." Tex. Prop. Code § 113.020.

A trustee should act reasonably in making a decision to pursue a claim. For example, in the Texas Estate's Code, it requires a representative of an estate to use diligence to collect property of the estate:

> (a) If there is a reasonable prospect of collecting the claims or recovering the property of an estate, the personal representative of the estate shall use ordinary diligence to: (1) collect all claims and debts due the estate; and (2) recover possession of all property to which the estate has claim or title.
>
> (b) If a personal representative willfully neglects to use the ordinary diligence required under Subsection (a), the representative and the sureties on the representative's bond are liable, on the suit of any person interested in the estate, for the use of the estate, for the amount of those claims or the value of that property lost by the neglect.

Tex. Estate Code § 351.151. It should also be noted that estate representatives have the same fiduciary duties as trustees. *In re Estate of Boylan*, No. 02-14-00170-CV,2015 Tex. App. LEXIS 1427, 2015 WL 598531 (Tex. App.—Fort Worth Feb. 12, 2015, no pet.).

Where there is clear liability and a defendant has the ability to pay a judgment, a trustee should generally pursue claims that would result in a benefit to the trust. In *Ward v. Stanford*, a trust beneficiary sued co-trustees for not suing the settlor for defaulting on a large debt owed to the trust. 443 S.W.3d 334, 346 (Tex. App.—Dallas 2014, pet. denied). The co-trustees alleged that the four-year limitations period barred the beneficiary's breach of fiduciary duty claim. The beneficiary alleged that it had sued within four years of the co-trustees failing to pursue the note claim based on a six-year limitations period for suing on a negotiable note. The trial court ruled for the co-trustees, and the beneficiary appealed. The court of appeals held that the six-year period applied for the co-trustees' note claim and that there was a fact issue as to when the beneficiary's breach of fiduciary duty claim accrued:

> To agree with appellant, we would have to conclude the Trustees—as a matter of law—did not violate their fiduciary obligation to appellant until the date limitations barred their claim against Travis Ward on the Renewal Note. To agree with the Trustees, we would have to conclude—as a matter of law—that they violated their fiduciary duty by not filing suit on the first day after the Renewal Note matured (either by its terms or by acceleration). Based on this summary judgment record, we decline to reach either conclusion.
>
> The fiduciary duty claims accrued when a wrongful act—an act or omission violative of the Trustees' fiduciary obligations to appellant—caused an injury, i.e. when they constituted "an invasion of . . . [appellant's] right . . . be the damage however slight." The ultimate issue remains: when did the Trustees' actions—or inaction—violate their fiduciary obligations and damage appellant?
>
> Certainly the accrual date for claims against Travis Ward based on the Renewal Note is a factor relevant to when the breach of fiduciary claims accrued, but it is not dispositive of that question. The Trustees

> did not prove as a matter of law that their failure to sue on the Renewal Note the day after it was due constituted a breach of their fiduciary duty. And neither does the evidence show as a matter of law that the Trustees' failure to pursue collection of the Renewal Note was consistent with the faithful performance of their fiduciary duties up to the last possible date they could have avoided Travis Ward's limitations defense by filing suit on the Renewal Note…
>
> [W]e conclude the date on which the Trustees' inaction can be said to cross the line into a breach of their fiduciary obligations to appellant remains a fact question.

Id. The court reversed the summary judgment for the co-trustees and remanded the beneficiary's breach of fiduciary duty claim to the trial court for trial on the merits. *Id. See also Proctor v. White*, 172 S.W.3d 649 (Tex. App.—Eastland 2005, no pet.) (reversed summary judgment on beneficiary's breach of fiduciary duty claim against trustee for loaning trust funds to himself because there was a fact question on the statute of limitations).

A trustee should seriously consider whether it should pursue claims on behalf of the trust, and if it does not do so, it should document that decision and its reasoning in the trust file.

C. Statute of Limitations For Pursuing Note Claims

A trustee should know what the statute of limitations is for suing on the debt. If the note is a negotiable instrument, then the trust has six years to sue the borrower for its default. Tex. Bus. & Com. Code Ann. § 3.118(a). If it is not, then the trust has a four-year period to bring its suit. Tex. Civ. Prac. & Rem. Code Ann. § 16.004(a)(3). The negotiability of an instrument is a question of law. *Ward v. Stanford*, 443 S.W.3d 334, 343 (Tex. App.—Dallas 2014, pet. denied). A promissory note is a negotiable instrument if it is a written unconditional promise to pay a sum certain, upon demand or at a definite time, and it is payable to order or to bearer. Tex. Bus. & Com. Code Ann. § 3.104(a). A trustee does not want to be in a position of having the statute of limitations lapse on a valid claim that should have been pursued. *JP Morgan Chase Bank, N.A. v. Robinson & Hoskins, L.L.P.*, No. 05-17-00087-CV, 2017 Tex. App. LEXIS 9467 (Tex. App.—Dallas Oct. 9, 2017, no pet.) (court affirmed summary judgment for debtor where note was not negotiable and the four-year limitations period applied); *Ward v. Stanford*, 443 S.W.3d 334, 343 (beneficiary had claim against co-trustees for not pursuing note claim during six-year limitations period).

D. Choice-of-Law Analysis

A trustee should be very careful to know which jurisdiction's law applies to a trust and a loan transaction with a trust. A trustee may be administering a trust in a jurisdiction that may allow certain lending transactions with beneficiaries and affiliates, but if the trust is construed under the law of another jurisdiction that does not allow such a transaction, then the trustee would be in breach. For example, in *The David F. King Trust Dtd 3/6/95*, an Oregon resident executed a will with a testamentary trust that incorporated Minnesota's broad trustee powers including the power of the trustee to make loans to any of the beneficiaries on such terms and conditions as the trustee deems appropriate. 295 Or.App. 176 (2018). After the settlor's death, his second wife, who was the trustee, made self-interested loans to herself, her son, and a business in which she had an interest. The settlor's children objected to the self-interested loans as violating Nevada law. The trust had a choice-of-law provision naming Nevada law. The Oregon appellate court held that because instrument itself unambiguously stated that Nevada law governed questions regarding administration of the trust and that Nevada law specifically prohibited insider loans by the trustee regardless of whether they are permitted by the terms of the trust, the trustee's loans to herself, her son, and interested business were breaches of her fiduciary duty to the trust beneficiaries. *Id*.

Accordingly, settlors should be very careful in determining the law that controls the administration of the trust and trustees should know what law applies and whether his, her, or its conduct is allowed under that law.

E. Advice of Counsel

When a trustee faces the difficult situations described above, the trustee should retain counsel to provide advice. Advice of counsel will provide protection that the trustee is complying with all legal requirements to avoid conflicts with governmental authorities. Further, advice of counsel may be a defense in any claim raised by a beneficiary. *In re Estate of Boylan*, No. 02-14-00170-CV,2015 Tex. App. LEXIS 1427, 2015 WL 598531 (Tex. App.—Fort Worth Feb. 12, 2015, no pet.). The Restatement provides:

> The work of trusteeship, from interpreting the terms of the trust to decision making in various aspects of administration, can raise questions of legal complexity. Taking the advice of legal counsel on such matters evidences prudence on the part of the trustee. Reliance on advice of counsel, however, is not a complete defense to an alleged breach of trust, because that would reward a trustee who shopped for legal advice that would support the trustee's desired course of conduct or who otherwise acted unreasonably in procuring or following legal advice. In seeking and considering advice of counsel, the trustee has a duty to act with prudence. Thus, if a trustee has selected trust counsel prudently and in good faith, and has relied on plausible advice on a matter within counsel's expertise, the trustee's conduct is significantly probative of prudence.

RESTATEMENT (THIRD) OF TRUSTS § 77 cmt. b(2), c. Therefore, following the advice of counsel can be evidence to show that a trustee acted prudently, though it, by itself, does not show prudence as a matter of law. To obtain the "silver bullet" defense, a trustee should seek instructions from a court. *Id*. § 93 cmt. c.

It should be noted that if a trustee asserts an advice of counsel defense, the trustee would likely waive any right to maintain privilege for those communications. If a party introduces any significant part of an otherwise privileged matter, that party waives the privilege. *See* Tex. R. Evid. 511. *See also Mennen v. Wilmington Trust Co.,* 2013 Del. Ch. LEXIS 238, 2013 WL 5288900 (Del. Ch. Sept. 18, 2013). For example, in *Mennen*, a trustee was sued for breach of fiduciary duty. *Mennen*, at *3. One of the trustee's defenses was that he received legal advice from counsel. *See id*. at *5. The trustee attempted to block production of the alleged bad advice from counsel, citing attorney-client privilege. *See id*. The court was unpersuaded by the trustee's invocation of privilege, stating that "a party's decision to rely on advice of counsel as a defense in litigation is a conscious decision to inject privileged communications into the litigation." *Id*. at *18 (citing *Glenmede Trust Co. v. Thompson*, 56 F.3d 476, 486 (3rd Cir. 1995).

XII. METHODS TO LIMIT TRUSTEE RISK FOR MAKING LOANS

If a trustee wants to reduce the risk associated with making a loan to a beneficiary or not pursuing a claim of default for such a loan, there are methods in Texas to protect a trustee from liability.

A. Non-Judicial Methods

1. Trust Language Allowing Loans

A settlor can add a clause to a trust that allows a trustee to make loans to a beneficiary. This can be a mandatory clause that requires a trustee to make loans. It can also be a permissive clause that attempts to limit the liability for a trustee making a loan, but also allows a trustee not to make such a loan. This can be an effective method to limit a trustee's liability.

Like everything else in the law, there is no definite language that will work in all circumstances: each trust is different. "As a general rule a trustee can properly make investments in such properties and in such manner as expressly or impliedly authorized by the terms of the trust." RESTATEMENT (THIRD) TRUSTS § 91, cmt. d.

Generally, a trust document's terms govern, and a trustee should follow them. Tex. Prop. Code Ann §§ 111.0035(b), 113.001; RESTATEMENT (THIRD) OF TRUSTS § 76(1) (2007) ("The trustee has a duty to administer the trust . . . in accordance with the terms of the trust . . . ."); RESTATEMENT (SECOND) OF TRUSTS § 164(a) (1959). "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.) (emphasis added). "The nature and extent of a trustee's duties and powers are primarily determined by the terms of the trust." RESTATEMENT (THIRD) OF TRUSTS § 90 cmt. B; *Stewart v. Selder*, 473 S.W.2d 3 (Tex. 1971); *Beaty v. Bales*, 677 S.W.2d 750, 754 (Tex. App.—San Antonio 1984, no writ). If the language of the trust instrument unambiguously expresses the intent of the settlor, the instrument itself confers the trustee's powers and neither the trustee nor the courts may alter those powers. *See Jewett v. Capital National Bank of Austin*, 618 S.W.2d 109, 112 (Tex. Civ. App.—Waco 1981, writ ref'd n.r.e.); *Corpus Christi National Bank v. Gerdes*, 551 S.W.2d 521, 523 (Tex. Civ. App.—Corpus Christi 1977, writ ref'd n.r.e.). The Texas Trust Code expressly provides that the prudent investor rule may be expanded, restricted, eliminated, or otherwise altered by the provisions of a trust. Tex. Prop. Code Ann. § 117.003(b). "A trustee is not liable to a beneficiary to the extent that the trustee acted in *reasonable reliance* on the provisions of the trust." *Id*. (emphasis added).

For example, in one case, the trust granted the trustee the power: "to lend money to any beneficiary hereunder, either with or without security and on such other terms as my executors may deem appropriate." *In re Hanes*, 214 B.R. 786, 822 (Bankr. E.D. Va. 1997). The court construed this language as: "The language of the above provisions expressly permits lending to the beneficiaries and the pledging of any assets to secure borrowing." *Id*. It held that the challenged loans were permissible: "Viewing the instruments and the circumstances as a whole, we find that it was Hanes, Sr.'s intention to give his sons broad authority to manage the Marital Trust in their absolute discretion. The family investment plan was a proper function of Hanes duties as Trustee. To the extent that the DCI Companies were investments made by HILP in furtherance of the family investment plan, the pledges securing lending directly to these entities was authorized." *Id*. *See also Bartlett v. Dumaine*, 128 N.H. 497, 501, 523 A.2d 1 (1986) (general language of trust allowed trustee to make undersecured loans in its discretion).

In another case the settlor and beneficiary amended the trust to allow the trustee to pay off debts owed from the beneficiary to the trustee from the trust. *See Hanson v. Minette*, 461 N.W.2d 592 (Iowa 1990). When the trustee did so, the court held that the beneficiary could not later complain of a conflict of interest:

> Hanson claims that the trustees engaged in impermissible self-dealing by selling Winnebago stock to pay off the loan Bankers Trust made to Hanson at the inception of the 1978 amendment. This loan was one of the primary reasons for amending the trust. The trust instrument expressly permitted the trustees to pay off Hanson's debts, and Hanson authorized the loan and its repayment. Under such circumstances there is no impermissible self-dealing.

Id.

Further, an express term of a trust which relieves a trustee of the risk associated with a loan to a beneficiary may also be considered an exculpatory clause. This concept is discussed below.

2. Exculpatory Clause

A settlor can add a clause to a trust that limits a trustee's liability for negligent activities or mistakes. Trusts often contain general exculpatory clauses, such as: "Except for willful misconduct or fraud, a Trustee shall not be liable for any act, omission, loss, damage or expense arising from the performance of his, her or its duties under this trust agreement."

There are certain statutory limits on exculpatory clauses. However, they are enforceable in Texas up to a point and can assist in limiting risk and liability. Texas Property Code Section 111.0035 provides that the terms of a trust may limit a trustee's duty, but may not limit a trustee's duty to act in good faith. Tex. Prop. Code Ann. § 111.035(b)(4). Additionally, Texas Property Code section 114.007 provides: "(a) A term of a trust relieving a trustee of liability for breach of trust is unenforceable to the extent that the term relieves a trustee of liability for: (1) a breach of trust committed: (A) in bad faith; (B) intentionally; or (C) with reckless indifference to the interest of a beneficiary; or (2) any profit derived by the trustee from a breach of trust." Tex. Prop. Code Ann. § 114.007. *See also Martin v. Martin*, 363 S.W.3d 221, 223-24 (Tex. App.—Texarkana 2012, pet. granted, judgm't vacated w.r.m.) (court affirmed a jury's finding of breach of fiduciary duty by a trustee and did not enforce the terms of an exculpatory clause due to statutory limitation of same). An exculpatory clause is effective in Texas and can protect a trustee from negligent actions or mistakes that fall short of being bad faith or grossly negligent.

Therefore, general exculpatory clauses can give a trustee some comfort that as long as they enter into loans in good faith, they will not be held personally liable for the transactions. However, whether a trustee acts in good faith or bad faith (or with gross negligence) is usually a fact issue for a jury to determine. For example, if a trustee makes a loan to a beneficiary who the trustee knows does not have assets or income to repay the loan, and the beneficiary later defaults, another beneficiary may argue that the trustee knew that the debtor/beneficiary would not repay the loan and wasted trust assets. A trustee does not want to fight the good-faith fight.

3. Statement on Special Circumstances

A settlor can add a statement to a trust that affects a trustee's duty to diversify a trust. A settlor can add statements to a trust that describe its purposes and special relationships to particular assets. Settlors can even describe investment plans and suggestions. For example, a settlor can describe the purpose of a trust as benefiting beneficiaries, provide that the trustee can make loans to beneficiaries, and state that such investments do not need to comply with the duty to diversify. "Indeed, if the trust is new and in the process of being drafted, counsel can greatly help the settlor and trustee minimize the diversification problem by being as specific as possible about the settlor's purposes of the trust, desires regarding negation of the duty to diversify, acknowledgment of the lack of marketability of the family company stock, and overall vision for the company." Elliott and Bennett, *Closely Held Business Interests And A Trustee's Duty to Diversify*, Trusts & Estates, trustsandestates.com (April 2009).

4. Other Related Documents

A family can create other related documents that may affect a trustee's duty to diversify. For example, assets (such as a loan) can be placed in closely held entities that limit a party's ability to dispose of the asset. That way, if a trustee wants to sell the asset or collect on a loan, it will have to have the consent of other parties. Further, the entity can have voting and nonvoting shares, and the settlor can fund the trust solely with nonvoting shares. That way, the trustee has no authority regarding the loan transaction.

5. Directed Trust Provisions

Texas has statutory provisions that allow a trust document to permit a trustee to delegate certain duties. Tex. Prop. Code Ann. § 114.0031. A trustee can delegate the investment decisions concerning a certain asset to a third party (maybe a family member) to determine whether to retain the asset or not retain the asset. "Depending on the trust's terms, the independent trustee may find relief from its duty to diversify by refraining from taking part in the family trustee's unilateral decision to continue the trust's concentrated holdings in the family company ownership." Elliott and Bennett, *Closely Held Business Interests And A Trustee's Duty to Diversify*, Trusts & Estates, trustsandestates.com (April 2009). "For example, if the terms of the trust provide that the family trustee's decision controls in the case of disagreements concerning loans to beneficiaries, the independent trustee could document (by trustee resolution or otherwise) its opposition to decisions concerning beneficiary loans and trigger relief from liability pursuant to the trust instrument." *Id*.

6. Decanting Trust

Texas has new statutory provisions that allow a trust to be decanted, i.e., the assets be transferred into a new trust. Tex. Prop. Code Ann. § 112.071-87. If a trust document does not contain any statements allowing loans to beneficiaries, perhaps the assets should be transferred into a new trust that has different administrative terms that allow a trustee to make the loans. The statute does state that a trustee may not use the decanting statute to "materially limit a trustee's fiduciary duty under the trust or as described by Section 111.0035" or "decrease or indemnify against a trustee's liability or exonerate a trustee from liability for failure to exercise reasonable care, diligence, and prudence." *Id*. § 112.085. This is a new statute in Texas and its limitations have not been fully developed.

7. Settlor Consent And Release

For a revocable trust, a settlor may revoke, modify or amend the trust at any time before the settlors' death or incapacity. Tex. Prop. Code Ann. § 112.051. Accordingly, in a revocable trust situation, a settlor may modify or amend a trust specifically to relieve a trustee from liability associated with loans to beneficiaries. *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). However, if the settlor becomes incapacitated, then a guardian must seek approval from a court to modify a revocable trust. *Weatherly v. Byrd*, 566 S.W.2d 292, 293 (Tex.1978). Additionally, the trustee should seek a written consent, release, and indemnity agreement from the settlor in a revocable trust situation and may also want to seek court approval.

8. Beneficiary Consent And Release

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, and this release must be in writing and delivered to the trustee. Tex. Prop. Code Ann. § 114.005. The trustee should be careful to word the release properly 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 it is in writing, signed by the beneficiary, and the beneficiary has legal capacity and full knowledge of the relevant facts. Tex. Prop. Code Ann. § 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*. A court may not enforce a release if disclosure was not adequate. *See, e.g., Hale v. Moore*, 2008 WL 53871 (Ky. Ct. App. Jan. 4, 2008). Release agreements should have detailed disclosures in the recitals and there should be written disclosures explaining release language.

For example, in *Burnett v. First National Bank of Waco*, the court dismissed a beneficiary's complaint about a loan transaction made by a trustee where the beneficiary had previously consented to it. 536 S.W.2d 600, 609 (Tex. Civ. App.—Eastland 1976, writ ref'd n.r.e.).

9. Beneficiary Written Directives

Many courts have held that it is appropriate for a trustee to consider an express direction from a beneficiary. Once again, the Prudent Investor Act lists certain circumstances that a trustee may consider in managing and investing trust assets, and one of those circumstances is "[a]n asset's special relationship or special value, if any, to the purposes of the trust or to one (1) or more of the beneficiaries." Tex. Prop. Code Ann. § 117.004(c)(8). The official comment to this statute explains that this subsection would allow the trustee "to take into account any preferences of the beneficiaries respecting heirlooms or other prized assets." *Id*. at cmt. Therefore, it was not improper for a trustee to consider a beneficiary's directions when considering whether to sell and diversify the assets in a trust. *See, e.g., Glass v. SunTrust Bank,* No. W2015-01603-COA-R3-CV, 2016 Tenn. App. LEXIS 305 (Tenn. Ct. App. May 4, 2016) (trustee did not breach duty by retaining stock where beneficiary sent letter requesting same); *Adams v. Regions Bank*, No. 3:14CV615-DPJ-FKB, 2016 U.S. Dist. LEXIS 1027, 2016 WL 71429, at *10 (S.D. Miss. Jan. 6, 2016) (concluding that "special circumstances" existed within the meaning of Mississippi's version of the Uniform Prudent Investor Act where the beneficiary approved of the retention of stock by signing a retention agreement; the trustee did not breach its duties by failing to diversify); *In re Trust Created By Inman*, 269 Neb. 376, 693 N.W.2d 514, 521 (Neb. 2005) (noting that a beneficiary's professed sentimental attachment to farmland could be a special circumstance justifying non-diversification); *Wood v. U.S. Bank, N.A*., 160 Ohio App. 3d 831, 2005 Ohio 2341, 828 N.E.2d 1072, 1079 (Ohio Ct. App. 2005) (stating that the "special circumstances" language in the UPIA includes situations involving "holdings that are important to a family or a trust"). As the *Glass* court stated:

> Having carefully reviewed the record, we agree with the trial court's conclusion that SunTrust did not breach a duty to Plaintiff by failing to liquidate the bank stock and diversify the portfolio. Plaintiff had executed written documentation electing an in-kind distribution of the stocks in the estate, acknowledging that SunTrust would continue to hold "these securities" for his benefit. Plaintiff's actions over the course of the next year were consistent with SunTrust's understanding of the in-kind election letter. The Glass family had owned these stocks for years, and they continued to pay large dividends to the trust during the administration period. SunTrust did not have a mandatory duty to diversify because it "reasonably determine[d] that, because of special circumstances, the purposes of the trust [were] better served without diversifying." Tenn. Code Ann. § 35-14-105(a)(1). Given the circumstances existing at the time, and the limited duration of the trust, SunTrust acted as a reasonably prudent person and was not negligent in its decision regarding diversification.

Glass, 2016 Tenn. App. LEXIS 305 at *35. Therefore, a trustee may seek an informal letter from beneficiaries instructing the trustee to make a loan, retain a loan in the trust's portfolio, not collect on loan, etc. Though not dispositive, such an instruction would be helpful.

10. Trustee Resolution

Another potential method to limit liability and risk is for the trustees to adopt a resolution containing a comprehensive investment plan that will apply from that time forward discussing the concentration of the investment and what factors the trustees will consider in the future to reevaluate the retention of the asset. "For example, the trustees could cite the settlor's desire that the family business stay closely held, intact and owned by family members or trusts for their benefits without regard to diversification." Elliott and Bennett, *Closely Held Business Interests And A Trustee's Duty to Diversify*, Trusts & Estates, trustsandestates.com (April 2009). The trustees could have the settlors and the beneficiaries sign off on this plan to show their consent and the settlor's intentions for the trust concerning loans to beneficiaries.

11. Beneficiary Ratification

Consents, in a perfect world, exist before a trustee begins managing an asset. If the trustee wants protection after it has been managing an asset for a while, a trustee may want to seek a ratification in addition to a consent and release. A beneficiary's knowledge and acquiescence in a trustee's failure to diversify may not be any protection for the trustee. A beneficiary's knowledge of a trustee's failure to invest trust funds does not, by itself, relieve the trustee from liability. *Landford v. Shamburger,* 417 S.W.2d 438, 445 (Tex. App.—Fort Worth 1967, writ ref'd n.r.e.), *disapproved on other grounds, Texas Commerce Bank v. Grizzle*, 96 S.W.3d 240, 251 (Tex. 2002). However, beneficiaries may be able to ratify a trustee's actions. *See Burnett v First Nat'l Bank of Waco,* 536 S.W.2d 600 (Tex. Civ. App.—Eastland, writ ref'd n.r.e.). Rather, the trustee should seek a written consent and release based on full information. If there are several beneficiaries, all of them must consent before the trustee is safe from liability. *See* RESTATEMENT (SECOND) OF TRUSTS § 216 cmt. g (1959). For the ratification to be valid, the ratifying beneficiaries should be aware of all material facts involved in the acts they ratify and of their rights in the matter, and must not be prevented from exercising those rights. *See e.g., Marcucci v. Hardy*, 65 F.3d 986 (1st Cir. 1995); *In re Estate of Lange*, 383 A.2d 1130, 1137-38 (N.J. 1978).

B. Judicial Methods

1. Judicial Modification Of Trust

If a trust document limits the trustee's ability to make loans or is silent on loans, the parties may seek a modification of the trust to accomplish that goal. A settlor of a revocable trust can amend the trust without judicial intervention. Tex. Prop. Code §112.051(a) ("A settlor may revoke the trust unless it is irrevocable by the express terms of the instrument creating it or of an instrument modifying it."); *Snyder v. Cowell*, No. 08-01-00444-CV, 2003 Tex. App. LEXIS 3139 (Tex. App.—El Paso Apr. 10, 2003, no pet.).

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 Ann. § 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*. Therefore, if all beneficiaries agree, it should be relatively easy to modify a trust document to insert appropriate language allowing loans to beneficiaries and limiting claims against a trustee for making those loans. The settlor and all beneficiaries may consent to modify a trust. *Musick v. Reynolds*, 798 S.W.2d 626, 629 (Tex. App.—Eastland 1990, writ denied). This requires that all parties have capacity to consent. *Id*. Even if all beneficiaries do not agree, it is still possible to do so, though it may be more difficult.

The most applicable provision is Section 112.054(a)(2), providing that a court may modify a trust if circumstances not known to or anticipated by the settlor will further the purposes of the trust. Tex. Prop. Code §112.054(A)(2). However, under this provision, a trial court cannot modify a trust solely on its own discretion; rather, it must consider the settlor's intent. For example, a court of appeals held that a trial court abused its discretion in modifying the terms of a trust and appointing a successor trustee because, while modification was necessary, the trial court erred by not exercising its discretion in a manner that conformed to the settlor's intent. *Conte v. Ditta*, 312 S.W.3d 951 (Tex. App.—Houston [1st Dist.] Mar. 11, 2010, no pet.). A trustee may have a difficult time establishing a settlor's intent where the settlor is no longer alive.

2. Judicial Approval

In addition to, or instead of, consents/releases/indemnities, a trustee or a beneficiary may seek court approval of a loan to a beneficiary. The Texas Trust Code allows for advance judicial approval. Tex. Prop. Code Ann. §115.001. The Texas Civil Practice and Remedies Code also 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; *Cogdell v. Fort Worth Nat'l Bank*, 544 S.W.2d 825, 829 (Tex. Civ. App.—Eastland 1977, writ ref'd n.r.e.) (the trustee settled claims and sought judicial approval of the settlement agreement).

Even where all parties consent and may agree to release the trustee, a trustee may still want a court order allowing the trustee to make a loan to a beneficiary. That is certainly the safest, most conservative approach. *In re Estate of Boylan*, No. 02-14-00170-CV, 2015 Tex. App. LEXIS 1427 (Tex. App.—Fort Worth Feb. 12, 2015, no pet.) ("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.").

3. Disclosure of Facts To Start Statute of Limitations

A trustee should disclose a loan to a beneficiary or any default thereof to the other beneficiaries so that the statute of limitations starts for any claims against the trustee. Texas courts apply a four-year statute of limitations for breach of fiduciary duty claims. Tex. Civ. Prac. & Rem. Code § 16.004(a)(5). As a general rule, a cause of action accrues when a wrongful act causes some legal injury, even if the fact of injury is not discovered until later, and even if all resulting damages have not yet occurred. *Murphy v. Campbell*, 964 S.W.2d 265, 270 (Tex. 1997). A "legal injury" is "an injury giving cause of action by reason of its being an invasion of a plaintiff's right . . . be the damage however slight.'" *Id.* (quoting Houston Water-Works Co. v. Kennedy, 70 Tex. 233, 8 S.W. 36, 37-38 (Tex. 1888)). Though, generally, accrual of a cause of action is a matter of law, it can be a fact question under the appropriate circumstances. *See Ward v. Standford*, 443 S.W.3d 334 (Tex. App.—Dallas 2014, pet. denied) (accrual was a fact question on when trustees breached duties by not pursuing a claim against the settlor).

Disclosure of the trustee's investment decisions is very important to the application of the statute of limitations defense. The discovery rule is an exception to the legal injury rule. *Murphy*, 964 S.W.2d at 270. Under the discovery rule, an action does not accrue until the plaintiff knew or in the exercise of reasonable diligence should have known of the wrongful act and resulting injury. *Id*. The discovery rule applies in cases of fraud, fraudulent concealment, and in other cases in which the nature of the injury incurred is inherently undiscoverable and the evidence of injury is objectively verifiable. *Id*.

Fraudulent concealment is also an affirmative defense to the statute of limitations. *KPMG Peat Marwick v. Harrison Cnty. Hous. Fin. Corp*., 988 S.W.2d 746, 749 (Tex. 1999). The party asserting fraudulent concealment has the burden to come forward with evidence raising a fact issue on each element of that defense. *See id*. A party asserting fraudulent concealment must establish an underlying wrong, and that "the defendant actually knew the plaintiff was in fact wronged, and concealed that fact to deceive the plaintiff." *BP Am. Prod. Co. v. Marshall*, 342 S.W.3d 59, 67 (Tex. 2011) (quoting *Earle v. Ratliff*, 998 S.W.2d 882, 888 (Tex. 1999)). Fraudulent concealment only tolls the running of limitations until the beneficiary discovers the fraud or could have discovered it with reasonable diligence. *Id*. Unlike the discovery rule, the doctrine of fraudulent concealment is fact-specific. *Id*.

Therefore, a beneficiary will not have a discovery rule or fraudulent concealment defense to the statute of limitations defense if the trustee properly and timely communicates to the beneficiary the investment decisions that it has made concerning loans to beneficiaries. For example, in *Thompson v. Butler*, beneficiaries sued a trustee for various allegations for breach of fiduciary duty. 2013 Ohio App. LEXIS 957 (Ohio Ct. App. Mar. 22, 2013). The beneficiaries alleged that the trustee breached his duties by not divesting of a concentration of stock. The court noted: "Ann Thompson testified that the discontinued divestment was an issue the Thompsons discussed in 2005, and Mark and Christie Thompson received quarterly account statements that would have shown the lack of sales. Therefore, if Key Bank stopped selling Key Corp. stock in 2005, the Thompsons knew or should have known about the discontinued divestment prior to July 2006." *Id*. *P21. The court affirmed the trial court's summary judgment on the basis of the statute of limitations: "Because the Thompsons filed their breach-of-trust claim more than four years after they knew or should have known the factual basis for each alleged breach, the trial court properly found the claim time barred. . . ." *Id*. at *P29.

It should be noted that although there is a four-year statute of limitations for damage claims in Texas, that there is no statute of limitations for suits to remove a trustee. *See Ditta v. Conte*, 298 S.W.3d 187 (Tex. 2009) ("[L]imitations periods continue to dictate when claims for fiduciary breaches must be brought. While the four-year limitations period proscribes whether an interested person can obtain monetary recovery from a trustee's fiduciary breach, it does not affect whether the interested person can seek that trustee's removal. To hold otherwise would allow trustees who previously harmed the trust relationship to remain in their fiduciary roles, regardless of their past transgressions.").

XIII. RAMIFICATIONS FOR INAPPROPRIATE LOANS

If a trustee fails to meet its fiduciary duties regarding a loan to a beneficiary or pursuing a default thereof, then there may be drastic implications for the trustee. At the end of the day, administering a trust is a balance of risk and reward. Reward being the compensation that a trustee earns and the risk being the chance that a beneficiary may sue a trustee for its actions or inactions. In this context, unfortunately, most determinations of whether a trustee breached its duty to diversify will be made after a loan has defaulted. As they say, hindsight is twenty/twenty. So, a judge or jury will be asked to determine whether a trustee breached its duty in making a loan after everyone knows that it went into default and caused harm to the trust. This is true even though the propriety of a trustee's investment strategy must be judged as it appeared at the time it was made and not when viewed in hindsight. *People's State Bank & Trust Co. v. Wade*, 269 Ky. 89, 106 S.W.2d 74, 76 (1937); *Estate of Pew*, 440 Pa. Super. 195, 655 A.2d 521, 523-24 (1994).

The Texas Trust Code has express remedies available to a beneficiary for a trustee's breach of fiduciary duty. Texas Trust Code section 114.008 allows a court to 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 Ann. § 114.008. Trust Code Section 113.082 provides that a court may remove a trustee if: 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; the trustee fails to make an accounting that is required by law or by the terms of the trust; or the court finds other cause for removal. *Id*. § 113.082. Court may reduce or deny a trustee compensation for breaches of duty. *Id*. §§ 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). Texas Trust Code section 114.064 provides: "In any proceeding under this code the court may make such award of costs and reasonable and necessary attorney's fees as may seem equitable and just." *Id*. § 114.064. Therefore, if a beneficiary sues for removal and/or breach of a duty, a court may order the trustee, individually, to pay the beneficiary's attorney's fees.

In addition to statutory remedies, a beneficiary may sue a trustee for breaching fiduciary duties and obtain legal remedies such damages, lost profits, etc. However, a beneficiary is not entitled to an award of damages for a trustee's breach of duty; any award should go to the trust itself. *Fetter v. Brown*, No. 10-13-00392-CV, 2014 Tex. App. LEXIS 11209 (Tex. App.—Waco October 9, 2014, pet. denied) (beneficiary was not entitled to award of damages as they should have been awarded to trust).

XIV. <u>CONCLUSION</u>

Trustees find themselves in very difficult positions when their beneficiaries request loans from a trust. Of course, every situation is different and there are no black and white rules. A loan can set the trustee up for potential liability if the beneficiary does not repay the loan, the trust is harmed, and there is no other adequate remedy to reply the loss to the trust.

However, a loan can serve the overall purposes of the trust by assisting a beneficiary and being an alternative to making an outright distribution to the beneficiary. In deciding on whether a loan is appropriate, a trustee may consider the following suggestions.

A trustee should first review the trust agreement and see if it allows a loan or prohibits a loan. If the trust prohibits a loan, absent some other action, the trustee should not make the loan. In this circumstance, if the trustee wants to proceed, it should seek to judicially modify the trust or at least obtain a release and consent from all interested parties. If the trust allows a loan under certain conditions, the trustee must follow the conditions set forth in the trust document. If the trust is silent on the issue, a trustee should conduct due diligence as set forth above and follow internal procedures for making a distribution to a beneficiary and should document it.

Regarding due diligence, the trustee should consider the beneficiary's ability to repay the loan, the collateral security requirements of the loan, and the appropriate market interest rate. If the trustee intends to make the loan on less than a commercially reasonable basis, the trustee should consider the loan as a partial distribution. As the trustee may be scrutinized for proper portfolio management by the beneficiaries or a court, it will want to either ensure that there is sufficient collateral for the loan or document that the trustee is treating the loan as a distribution.

The trustee and beneficiary should also consider that if the beneficiary is unable to repay the loan, the loan could be challenged by the IRS and re-characterized as a distribution that may cause an adverse income tax result for the beneficiary. Further, a trustee should ensure that a loan made to a trust beneficiary should be supported by appropriate documentation, such as a promissory note, security agreement, deed of trust, etc.

Potentially, the trustee can ensure that the trust can make the loan payments directly. A trustee should also consider that upon default, the trustee could repay the loan from distributions the beneficiary might otherwise have been entitled to receive from the trust.

In the end, the trustee should consider the impact that such a loan will have on trust assets, investment strategy, the beneficiary, other beneficiaries, and tax implications. The trustee and/or beneficiary should obtain financial and legal advice before completing a loan agreement and before any demand for repayment is made.