Trustee Compensation in Texas

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Areas of Discussion

- Today, we will discuss the following:
- Duty of loyalty;
- Authority for trustee compensation;
- Factors for reasonable compensation;
- Other issues arising from trustee compensation;
- Potential ramifications for improper compensation.

Duty of Loyalty

- A trustee owes a trust beneficiary an unwavering duty of good faith, loyalty, and fidelity over the trust's affairs.
- The duty of loyalty prohibits a trustee from using the advantage of his position to gain any benefit for himself at the expense of beneficiaries and from placing himself in any position where his self-interest will or may conflict with his obligations as trustee.

Duty of Loyalty

- 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. Trust Code § 117.007.
- Contrast with “best interest” standard for RIAs, where a party does not violate the duty of loyalty merely because its conduct furthers its own interest.
- Best interest standard allows a win/win situation, whereas a sole interest standard does not, it must be win/neutral situation.

Duty of Loyalty

- In *Slay v. Burnett Trust*, the Court found a breach of loyalty where trustees loaned funds to a venture in which the trustees had an ownership interest. 187 S.W.2d 377 (Tex. 1945). Profits for the venture were divided between the trustees.
- "It is a well-settled rule that a trustee can make no profit out of the trust. The rule in such case springs from his duty to protect the interests of the estate, and not to permit his personal interest in any wise to conflict with his duty in that respect. The intention is to provide against any possible selfish interest exercising an influence which can interfere with the faithful discharge of the duty which is owing in a fiduciary capacity."
- The Court noted: "Funds of the Trust were loaned and used to make the investment and to enter upon the venture. The Trust had all of the risk of loss and the parties named had all of the opportunity for profit." *Id*.

Duty of Loyalty

- The "sole interest" is so intense that, in most circumstances, its prohibitions are absolute for prophylactic reasons.
- It may be difficult for a trustee to resist temptation when personal interests conflict with fiduciary duty.
- In such situations, for reasons peculiar to typical trust relationships, the policy of the trust law is to prefer to remove altogether the occasions of temptation rather than to monitor fiduciary behavior and attempt to uncover and punish abuses when a trustee has actually succumbed to temptation.
- This policy of strict prohibition also provides a reasonable circumstantial assurance that beneficiaries will not be deprived of a trustee's disinterested and objective judgment.

Duty of Loyalty

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

Potential Conflicts of Interest

- There are many instances where a trustee can have a conflict of interest: compensation, transfer of fiduciary appointments, borrowing money, bank deposits, investments, purchasing assets, real estate commissions, lending/dispersing trust funds, hiring agents, etc.

What is Not a Conflict of Interest

- What is not a conflict of interest?
- Reasonable compensation unless the trust does not allow compensation. Trust Code § 114.061; *InterFirst Bank Dallas, N.A. v. Risser*, 739 S.W.2d 882 (Tex. App.—Texarkana 1987, no writ).
- Trustee should carefully review trust document and follow any terms therein regarding compensation.
- Benefits and detriments to strict terms vs. liberal terms.
- Potential solution is suit to modify or reform a trust.

Reasonable Compensation

- Some states have a statutory formula for compensation.
- In Texas, Section 114.061 provides:
- "(a) Unless the terms of the trust provide otherwise and except as provided in Subsection (b) of this section, the trustee is entitled to reasonable compensation from the trust for acting as trustee."
- No definition or guidance on "reasonable compensation."

Reasonable Compensation

- There is very little common-law authority that assists in determining “reasonable compensation” for a trustee.
- The main case in Texas on trustee compensation provides that the amount of compensation that a trustee is permitted to charge must be reasonable, having regard to the trustee’s responsibility and the care and labor bestowed. *Beaty v. Bales*, 677 S.W.2d 750 (Tex. App.—San Antonio 1984, writ refused n.r.e.).
- Texas cases have affirmed what the fact-finder determines to be reasonable based on evidence.

Reasonable Compensation

- There are statutes and common law from other jurisdictions that provide factors for determining reasonable compensation.
- The custom of the community;
- The trustee's skill, experience, and facilities;
- The time devoted to trust duties;
- The amount and character of the trust property;
- The degree of difficulty, responsibility and risk assumed in administering the trust, including in making discretionary distributions;
- The nature and costs of services rendered by others;
- The quality of the trustee's performance

Reasonable Compensation

- The degree of responsibility required by law;
- The degree of responsibility that a trustee has under the terms of the trust instrument;
- The success or failure of the trustee’s administration;
- The trustee’s fidelity or disloyalty;
- Opportunities that the trustee has given up; and
- The trustee’s estimate, if any, of the value of his or her services.

Reasonable Compensation

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

Apportionment of Compensation

- The payment of trust expenses as between principal and income can be a very important issue.
- The Uniform Principal and Income Act establishes rules for allocating various disbursements between principal and income. Tex. Prop. Code 116.201-202.
- The trustee’s compensation and fees for investment advisors or custodial services are divided evenly between principal and income unless a trustee or a court determines that a different portion, none, or all of the compensation should be allocated to income.

Compensation for Co-Trustees

- Where there are multiple trustees, the combined compensation must be reasonable.
- When there are two or more co-trustees, compensation is ordinarily to be divided among them in accordance with the relative value of their services.
- In the aggregate, the reasonable fees may be higher than for a single trustee.
- Co-trustees should communicate about relative tasks and set compensation accordingly and communicate with the beneficiaries regarding those decisions.

Attorney's Fees Comparison

- In Texas, unlike trustee compensation, there is an abundance of authority for how to properly calculate reasonable attorney's fees.
- May be easy to simply use a lodestar method (hourly) for trustee compensation in disputes.
- Most jurisdictions reject this approach.
- *Robert Rauschenberg Found. v Grutman*, 198 So 3d 685 (Fla. 2016).

Extra-Compensation

- A trustee may seek additional compensation (in addition to reasonable trustee compensation for administration services) for providing other types of services to the trust.
- Commentators point out the obvious conflict situation: trustee hiring itself to do work that others may do better or for a less expensive cost.
- Yet, in Texas, where it is done in good faith and with reasonable compensation, it may be allowed.
- If ever challenged, trustee will likely have the burden to prove the fairness of this self-interested transaction.

Other Benefits

- The process of administering a trust, a trustee may have the opportunity to obtain other benefits, aside from direct compensation.
- Once again, a duty of loyalty does not allow a trustee to benefit from its fiduciary relationship other than from direct compensation.
- The Restatement provides: “A trustee engages in self-dealing and therefore normally violates the duty of loyalty by personally accepting from a third person any fee, commission, or other compensation for an act done by the trustee in connection with the administration of the trust.”
- Trustees should look to statutes that allow certain transactions despite conflict of interest situations.

Duty to Disclose

- The Texas Supreme Court has stated that "trustees and executors have a fiduciary duty of full disclosure of all material facts known to them that might affect [the beneficiaries'] rights." *Huie v. DeShazo*, 922 S.W.2d 920 (Tex. 1996).
- Disclosure meets a trustee's fiduciary duty and also starts the statute of limitations running.
- Also, certain equitable defenses may apply: laches, waiver, estoppel, and quasi-estoppel. *Goughnour v. Patterson*, No. 12-17-00234-CV, 2019 Tex. App. LEXIS 1665 (Tex. App.—Tyler March 5, 2019, pet. filed).

Settlor Agreement

- Settlor consent/release if revocable trust.
- Trust Code § 112.051 – a settlor may revoke a trust unless it is irrevocable by express terms.
- Settlor can modify or amend a revocable trust.
- If the settlor is incapacitated, a court must authorize a guardian to revoke or modify a revocable trust. *Weatherly v. Byrd*, 566 S.W.2d 292, 293 (Tex. 1978).

Beneficiary Agreement

- A beneficiary who has legal capacity and is acting on full information may relieve a trustee in writing from any duty, responsibility, restriction, or liability, including liability for past violations. Trust Code § 114.005; 114.001 (consent to compensation terms).
- Releases are enforceable if the beneficiary has full knowledge of the circumstances surrounding the agreement, has capacity, and signs the agreement. Trust Code § 114.032.
- Minors are bound if a parent signs, there are no conflicts between the minor and the parent, and there is no guardian for the minor. *Id*.

Beneficiary Agreement

- Releases are enforceable if the beneficiary has full knowledge of the circumstances surrounding the agreement. Trust Code § 114.032.
- A court may not enforce a release if disclosure was not adequate. *See, e.g., Hale v. Moore*, 2008 WL 53871 (Ky. Ct. App. January 4, 2008).
- Release agreements should have detailed disclosures in the recitals and there should be written disclosures explaining release language.

Court Agreement

- Texas Trust Code allows for advance judicial approval. Trust Code § 115.001.
- Texas Civil Practice and Remedies Code allows a court to declare the rights or legal relations regarding a trust and to direct a trustee to do or abstain from doing particular acts or to determine any question arising from the administration of a trust. Tex. Civ. Prac. & Rem. Code Ann. § 37.005.

Ramifications

- Trust Code § 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.

Removal

- 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
  - <u>the court finds other cause for removal</u>.

No Limitations for Removal

- In *Ditta v. Conte*, the trial court removed the trustee due to a conflict of interest (she had borrowed money from the trust). 298 S.W.3d 187 (Tex. 2009).
- The court of appeals held that limitations prevented the removal.
- The Texas Supreme Court held that limitations does not apply to removal actions and affirmed the trial court's removal: "While removal actions are sometimes premised on a trustee's prior behavior, they exist to prevent the trustee from engaging in further behavior that could potentially harm the trust. Any prior breaches or conflicts on the part of the trustee indicate that the trustee could repeat her behavior and harm the trust in the future."

Disgorgement of Compensation

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

Punitive Damages

- Intentional breach of fiduciary duty may give rise to a punitive damages claim.
- That claim may not be capped if the plaintiff proves that the defendant committed a misappropriation of fiduciary property crime.
- Intentional breach-of-fiduciary-duty judgments may not be dischargeable in bankruptcy.

Attorney's Fees

- Trust Code 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."
- So, 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.

Policing Co-Trustees

- Trustees have potential liability for co-trustee's actions if the trustee does not act with reasonable care. Trust Code § 114.006.
- Trustee should exercise reasonable care to prevent a co-trustee from over compensation and compel a co-trustee to redress same.
- Trustee may need to seek accountings and disclosures from a co-trustee.

Conclusion

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