

Question 9 Selected Answer

1. Yes. As the beneficiaries of the principal of the trust, Carol and ray has standing to challenge the actions by mark as trustee. Mark owes them, beneficiaries, fiduciary duties to not engage in self dealing or imprudent investing, as well as the settlor. Therefore the settlor or beneficiaries (both income and principal) may challenge actions of the trustee.
2. No, even though Mark was not appointed trustee, he engaged in conduct which shows that he accepted the role of trustee. By placing the trust assets in the trust, investing the assets and signing as trustee, Mark exercised effective control over the trust to establish that he is in fact a trustee. It is not necessary for the court to appoint a trustee, but a court is necessary for the removal of a trustee.
3. a.) Carol and Ray may assert a breach of fiduciary duty by engaging in self-dealing. A trustee may not deal with the trust assets for his personal benefit. Although Mark is also the income beneficiary he has a duty to preserve trust assets for the principal beneficiaries. By pledging trust stock as collateral, Mark engaged in self-dealing and breach of duty by invading the trust principal. Carol and Ray are entitled to have Mark removed as trustee and to have him pay for the losses. The loan may also be characterized as self-dealing, however since mark is paying interest it may also benefit from the loan, however, the interest paid on the loan goes directly back to Mark as income from the trust. Therefore Carol and Ray are likely to succeed against Mark and are entitled to damages for any losses caused by the transaction, to set aside the loan and to removal Mark as trustee.  
  
b.) Although Carol and Ray may assert a claim for imprudent investing for the sale of Bland and the purchase of Tejas, Mark has a defense from the uniform prudent investor statute. The UPI saves mark from liability because the transaction is evaluated at the time the investment was made and not by hindsight. Here at the time Mark made the investment, he in good faith and the facts show that the investment is reasonably prudent. Bland was giving a low return and Tejas at the time was doing well. Mark is not liable for the losses on this transaction because it was reasonably prudent at the time therefore Ray and Carol does not have a strong claim against him here.

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1. Yes, Carol and her son Ray have standing to sue Mark. Since Mark's interest is a life estate in the trust, Carol and Ray remainder interest have already vested. A party who has a vested remainder interest in a trust has standing to sue because, even though they have no right to trust property now, they will have one in the future. Here, that right is realized for Carol and Ray once Mark dies.

2. A trust will not fail for lack of a trustee. Jane refused to be trustee as appointed by Tom the Settlor. However, under normal circumstances, the court would appoint a trustee for the trust. Under these facts, this never happened here.

Here, Mark will not win this defense. Mark will be estopped from claiming that he cannot be liable to Carol or Ray because he was never appointed "trustee" of the trust by the will or a court. If a person assumes such a position as trustee, tries to take advantage of the benefits of the trust, and does not follow the fiduciary duties which are involved, and therefore, causing harm to 3<sup>rd</sup> parties, they will be estopped from denying liability.

Normally to become a trustee you either would have to be named in the trust instrument or appointed by the court. Neither of these are present here. However, Mark took it upon himself to step into the role as trustee. By doing this he caused harm to the trust res (property) and therefore, harm to Carol and Ray who are the remainderman.

Estoppel is an equitable doctrine made for policy reasons. The court uses it for public policy reasons to protect 3<sup>rd</sup> parties. A person can not hold themselves out as trustee one day and then disclaim liability when their actions cause harm.

3. a.) Carol and Mark have a cause of action against Mark for self-dealing connected to the State Bank Loan and the loan from the trust to Mark. A trustee can not self-deal. Self-dealing can be waived in the trust instrument, but under these facts this has not happened here.

A trustee breaches their fiduciary duty to the trust and commits self-dealing when they make a loan to themselves of trust property. Here, Mark loaned himself \$25,000 from the trust which constitutes self-dealing. It is irrelevant that he gave the trust a promissory note with a commercially reasonable rate of interest. A trustee loaning themselves money from the trust is self-dealing and a breach of fiduciary duty no matter what conditions are placed on the loan.

A trustee also commits self-dealing when they pledge trust res as collateral for a loan. Here, that is what Mark did with the State Bank loan. It is irrelevant that Mark may never default on the loan. Mark has put trust res at risk which is considered self-dealing and equals a breach of a trustee's fiduciary duty.

Carol and Ray can get an injunction against Mark and can get him removed as trustee even though he is not a real trustee. They also can recover any actual damages that Mark has caused. Any profits Mark has received can be given back to Carol and Ray in a constructive trust.

b.) Mark's decision to sale the Bland Company stock and purchase Tejas stock likely does not rise to a cause of action for Carol and Ray.

A trustee has a fiduciary duty to invest as a ordinary prudent investor would invest and as he would invest his own property. They have a duty to diversify their investments of the trust res also.

Here, Mark sold the Bland Company stock because it was producing an unusually low rate of return. He decided to invest in Tejas stock which had high return rates for 5 years. This likely is what a prudent investor would due too. You look at what a prudent investor would do at the time of the investment, not at the outcome of the investment.

Carol and Ray likely have no cause of action against Mark for this sale and investment because he likely met the prudent investor standard.

END OF EXAM

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1. Yes, Carol and her son Ray do have standing to assert a claim for themselves or the trust. Under the Texas Trust Code, any party who has an interest in the trust can have standing to assert a claim against the trustee, but not the trust (the trust is not an entity that can be sued). Here, Carol and her heirs were named residuary beneficiaries, Ray was also included as a residuary beneficiary under the facts of the case. Even though Mark was a beneficiary for life, his actions were directly adverse to the pecuniary interests of Carol and Ray. Therefore, they had standing under the Texas Trust Code.
2. Ray is not likely to succeed with this defense. Under the Texas Trust Code, when Jane declined to serve as trustee, the court was supposed to appoint a trustee. However, in a situation like this, Mark voluntarily assumed the actions of a trustee. In a situation where a beneficiary assumes the position of a trustee when there is no trustee, the Court will usually hold that the beneficiary is also the trustee. Therefore, Mark's defense will not be valid.
3. a.) With respect to the State Bank loan and the loan from the trust to Mark, Ray and Carol can assert that Mark was involved in self-dealing. Under the Texas Trust Code, a trustee commits self-dealing when he borrows money from the trust for his own economic gain. Here, Mark borrowed \$100,000 from State Bank, pledging trust stock, and he borrowed \$25,000 from the trust. That is clear self-dealing. It can also be argued that Mark breached a fiduciary duty when he was involved in this self-dealing. A trustee has to do what is in the best interest of the beneficiaries, and in this case Mark was draining the trust for his benefit.

What Ray and Carol can do, assuming they have a cause of action, is ask the court to impose a constructive trust on any benefits Mark has gained as a result of the trust. Under Texas law, to impose a constructive trust (which is not a trust), there must be (1) unjust enrichment and (2) wrongful conduct. Here the draining of the trust was wrongful, which led to Mark's unjust enrichment (he got money from the trust and a loan).

Therefore, Ray and Carol could ask for a constructive trust in this case.

b.) With respect to the sale of the Bland Company Stock and the purchase of the Tejas stock, Ray and Carol can assert that Mark violated the Uniform Prudent Investor Act. Under the Uniform Prudent Investor Act (UPIA), the trustee has a duty to invest the trust funds in a reasonable and prudent manner. When determining prudence, however, one should not look at the investment from hindsight. Rather, when determining prudence, one should look at prudence at

the time the investment was made. Here, mark sold the Bland Company stock from the trust because at the time it was producing an unusually rate of return. Then, when he bought the Tejas stock, Mark saw that Tejas had a 5 year record of unusually high rates. Carol and Ray may argue that Mark should have noticed that since the stock was unusually high, it had to come down. Mark can point out, however, that the high rates were a result of the success in developing foreign production facilities, and there was probably more chance of success. Mark could also assert that no prudent investor would have been able to have foreseen a revolution in a country whose new government nationalized the stock. Mark could argue that he was prudent, and under these facts, he is not liable under the UPIA.

END OF EXAM