(1) Willard has violated his duties as trustee of the trust with respect to (a) investing in the racehorse; (b) purchasing the stock from the trust; (c) paying himself the 6% commission from the sale of the 300 acre parcel; (d) and possibly paying $20,000 per year out of the trust assets, depending on how much the trust has grown.

A trustee owes the utmost fiduciary duties to act as a prudent investor and to refrain from self-dealing. A settlor by agreement may eliminate the fiduciary obligation of refraining from self-dealing by agreement.

As part of the duty of care as a prudent investor, the trustee must consider the assets overall along the lines of a portfolio for investment. This requires looking to the assets of the trust as a whole and diversify based on the current market, general economic conditions, the trust's purpose, what role each investment plays in the portfolio and the return of each investment with respect to the total return.

(a) Racehorse

The investment in the racehorse offered a diverse option to the trust and promise of return based on the horse's bloodline. However, Willard breached his duty to refrain from self-dealing, and therefore, he violated his duty as trustee. First, there does not appear to be any agreement by which Ronald obviated Willard from his duty to refrain from self-dealing.

Self-dealing occurs when the trustee causes the trust to invest in property of someone who has a familiar or close relationship with the trustee. The problem with self-dealing is not that someone may profit, but that the trustee will not use his best judgment in investing for the trust.

Here, Willard caused the trust to invest in property that belonged to his girlfriend. While in hindsight the investment may prove fruitful, it is self-dealing and a violation of this fiduciary duty. Therefore, Willard violated this duty with respect to the racehorse.

(b) Willard also violated his fiduciary duty to the trust in purchasing the stock. For the same reason the Texas law prohibits interested transactions with family members, it prohibits the trustee from purchasing trust property from the trust even at fair market value. The trustee's business judgment becomes clouded and he cannot make decisions in the best interest of the trust. Furthermore, it presents the untenable situation for the trustee who may lose sight of whether the acquisition is for his own benefit or the benefit of the trust. For that reason, Willard violated his duty as trustee when he acquired the stock from the trust property because in the absence of an agreement, this is forbidden.

(c) Willard did not violate his duty when he sold the parcel of land. As set forth supra, a trustee has the duty as a prudent investor to diversify the trust assets and get the best return. Here, Willard made a prudent investment, which proved to be a windfall for the trust, and was not a violation of his duties.

However, Willard did breach his duty in taking the 6% commission. A trustee is entitled to reasonable compensation for performing his duties as trustee, rather than a commission (unlike an estate representative). In taking the commission he engaged in self-dealing, which is a violation of his trust duties.

(d) It is not clear whether the compensation of $20K/year is a violation of his duties. A trustee is entitled to reasonable compensation. It appears the trust corpus is far more than $1 million. Hence, $20,000 per year may be a reasonable compensation. Here, the facts don't indicate the overall value of the trust so it is hard to determine if he is engaging in self-dealing given the remaining stock, the money and the money out of the sale of land.

(2) Bonnie may disgorge Willard of any profits he has reaped from his self-dealing. First, if his girlfriend was aware of his self-dealing, she may be compelled to return the $25K for the horse; otherwise, Willard may be held liable for it. With respect to the stock, Bonnie may ratify the sale (particularly if there has been a decline in value) or she may compel return, or she may compel any profits to be turned over to the trust.

With respect to the commission, Bonnie may disgorge him of this.

Depending on the relative value of the trust, Bonnie may compel Willard to reimburse the trust for any amounts that would be in excess of reasonable compensation.

END OF EXAM

(1) (a) Investing in the Racehorse

This investment likely violated Willard's duty as trustee. A trustee, under the Uniform Prudent Investor Act (UPIA), has a duty to act as a reasonably prudent investor would act when investing trust assets. The trustee's prudence is determined at the time of the investment. Factors to take into account include the price of the investment, the rate of return, and the market for such investment. The trustee has a duty to diversify trust investments. A trustee cannot be held liable simply because the investment failed if at the time of the investment he acted as a reasonably prudent investor.

Here the investment in the race horse cannot be said to have been a reasonably prudent investment. This is aside from the fact that the race horse is owned by his girlfriend. A trustee may not invest trust funds in a company owned by himself or a family member. He also cannot invest funds when he is a majority shareholder in the corporation. Here, although the investment was made to a racehorse owned by his girlfriend rather than a family member, it would still be self dealing. Even if not, the investment cannot be one that a reasonably prudent investor would have made.

(b) Purchasing the wind power stock

Willard breached his fiduciary duty as trustee by purchasing a trust asset. Although a trustee may sell trust assets to further the benefit of the trust, he may not purchase trust assets himself, no matter how fair the deal. Therefore since the wind power stock was a trust asset he has breached his fiduciary duty by the purchase and thus violated his duty as trustee.

(c) Selling the 300 acre parcel of land did not violate Willard's duties as trustee, however taking the commission from the sale did violate his duties.

A trustee can do pretty much anything a fee simple owner could do with regard to real property held by the trust. Therefore a trustee may sell trust land in order to benefit the trust. However a trustee cannot profit off the sale, as a trustee is only entitled to reasonable compensation.

Here the sale of the land was proper and in fact it was a good action on the part of Willard because it earned the trust a large profit. However Willard was not entitled to receive a commission off the sale, because he is only entitled to receive reasonable compensation for activities done while acting as trustee.

(d) Paying himself compensation for acting as trustee

A trustee is entitled to reasonable compensation. 5% of the trust assets for payment to a trustee has been held as reasonable. Therefore the $20,000 payment that Willard paid himself would likely be reasonable as that is under 5% of the total value of the trust assets. Here the trust property exceeds well over 1 million dollars therefore the $20,000 payment is reasonable compensation.

(2) Bonnie cannot only have Willard removed for his breach of fiduciary duties as trustee, but she may also get money for Willard's breaches.

Bonnie will be entitled to get back the 6% sale commission that Willard took off the land sale as that money belonged to the trust. A profit from the sale of trust property belongs to the trust.

She can also have a claim for a construction trust for the $25,000 dollars paid for the racehorse investment, as this was a non prudent investment. She will also be able to either recover the stock sold to Willard or the fair market value of the stock at the time of the sale.

END OF EXAM

11)

<u>Discussion of whether the following actions violated Willard's duties as trustee</u>

The issue is that Bonnie has become increasingly concerned over Willard's actions as trustee, specifically with regards to four actions taken by Willard and has sued to determine if the actions have violated Willard's duties as trustee. A trust is a fiduciary relationship where one person ones legal title to property subject to an equitable obligation to care and mange the property for another. As the trustee Williard owes Bonnie the beneficiary of the trust many duties. The duties consist of:

(1) duty of due care
(2) prudent investor rule
(3) diversify the trust assets
(4) earmark the trust assets
(5) follow the instruction of the trust granting language
(6) supervise anyone who they assign to perform services for the trust
(7) avoid self dealing
(8) accounting

As the beneficiary Bonnie can take the following actions in light of a trustee's breach of their duty. She can:

(1) surcharge the trustee
(2) seek recission of the contract the trustee entered into in volation of their duty
(3) sue to compel the trustee to take a certain act
(4) sue to enjoin the trustee from taking a certain act
(5) seek removal of the trustee

If a trustee is found liable for breaching its duties to the trust and the beneficiary there are a couple of remedies available to the court. First, it can protect against any self dealings by creating a constructive trust around any property or profits obtained due to the self dealing. Next, it can force the trustee to return any property taken from the trust. Also, it can make the trustee pay damages to the trust for violating one of the above duties.

Now let's look to whether Willard specifically violated any of the duties owed to the trust and to its beneficiary Bonnie.

(a) investing in the racehorse

A trustee has the implied right to buy, sell, transfer or dispose of any trust propert in which it believes its in the best interest of the trust to do so. First, ignoring the fact that the racehorse was owned by Williards girlfriend buying the race horse would be a breach of the duty of due care and the prudent investor rule. While Williard attempts to argue that he was justified because he was diversifying the trust assets this argument will fail. In determining whether to make certain invesments the trustee should consider:

(1) the economic benefits
(2) long term benefit of the trust portfolio
(3) the effect of the purchase on the overall portfolio

As we all know horse racing is gambling. There is no sure things with gambling. The same thing is true for owners of horses. Just because a horse is breed from an excellent bloodline does not guarantee its will be a winner. Willard will have breached his duties by investing $25,000 of the trust assets in the racehorse.

Now looking to the fact that the racehorse is owed by his girlfriend. This would be a form of self-dealing which a trustee cannot do with trust property. He has the potential to benefit outside of the trust by investing in the horse with the trust's money.

(b) purchasing the windpower, inc stock from the trust

Purchasing property from the trust would be a clear violation of his duty to avoid self-dealing. A trustee should not purchase trust property. This demonstrates that there is a great benefit in the property which should be used to benefit the trust not the trustee. This would also be a violation of the duty of care owed to the beneficiary. As the trustee Williard cannot take away any benefits owed to the trust. The stock could substantially increase in value and then Bonnie as the beneficiary would be deprived of substantial income and future benefits. Any argument made by

Williard that he did not deprive the trust of any value because he paid market value would fail because as stated the stock could increase in value. Looking at the duty owed as a prudent investor Williard would have to consider the benefits of the stock long term to the trust. Williard violated his duties as trustee by selling to himself 1/2 of the windpower, inc stock.

(c) selling the 300 acre parcel of land and taking a commission from the sale

First, in looking at the sell of the 300 acre parcel of land. The corpus body of the trust only consisted of the 300 acres, the windpower, inc. stock and $1,000,000 in cash. By selling the 300 acres Williard sold a substantial part of the corpus body of the trust. A trustee has the implied right to buy, sell, transfer or dispose of any trust propert in which it believes its in the best interest of the trust to do so. The facts tell us that the sale resulted in a large profit to the trust. It appears based on the fact that the sale resulted in a large profit that Williard was proper in making the sale because he was compliant in his duty of care to the trust. He had the ability to sell the parcel of land for a large profit and the profit only increased the income and future beneficiary for Bonnie.

Now looking to whether Willard violated his duties as trustee by taking a commission from the sale. A trustee is allowed reasonable compensation if it acts in its professional capacity for the benfit of the trust. A trust cannot receive free services solely because it chose to have a real estate agent as the trustee. Any acts or servies performed by Williard in his professional capacity are seperate from his duties and obligation as trustee and are compensable by the trust.

In conclusion, Williard did not violate his trustee duties by selling the 300 acre parcel of land and taking a commission from the sale

(d) paying himself compensation for acting as trustee

A trustee is not entitled to compensation without court approval. A trustee is entitled to be reimbursed their reasonable expenses upon proof to the court of the expenses. However, on application to the court a judge can grant the trustee compensation. The amount of compensation will be determined within the discretion of the judge by looking at the trustee's actions and the corpus body of the trust. Texas statutes set a trustee's yearly compensation to be paid 1/2 from the income of the trust and 1/2 from the principal of the trust.

In conclusion Willard violated his trustee duties by not seeking court permission and authority for compensation.

<u>Bonnie has numerous remedies for Willard's violations of his duties as trustee</u>

The issue is what remedies Bonnie has for Willard's violations of his trustee duties. As the beneficiary Bonnie can take the following actions in light of a trustee's breach of their duty. She can:

(1) surcharge the trustee
(2) seek recission of the contract the trustee entered into in volation of their duty
(3) sue to compel the trustee to take a certain act
(4) sue to enjoin the trustee from taking a certain act
(5) seek removal of the trustee

If a trustee is found liable for breaching its duties to the trust and the beneficiary there are a couple of remedies available to the court. First, it can protect against any self dealings by creating a constructive trust around any property or profits obtained due to the self dealing. Next, it can force the trustee to return any property taken from the trust. Also, it can make the trustee pay damages to the trust for violating one of the above duties.

Looking at the above violations Bonnie has numerous remedies available to her. First with regards to investing in the racehorse. Bonnie can sue Willard and seek recission of the investment. Additionally, she can sue Willard and seek recovery of the $25,000 from Williard personally for violating his duties to the trust. Next, with regards to the purchasing of the windpower, inc stock she can sue and seek the court create a constructive trust in favor of Bonnie over the 5,000 shares. By doing so she would basically be forcing Willard to return the shares of stock to the trust. Finally, with regards to the prior compensation Bonnie can ask for a return on all of the compensation minus the amount of compensation found reasonable and justifiable by the court.

In conclusion, Bonnie has numerous remedies available to her including, seekign recission of the investment, seeking recovery of the money invested personally from Williard, asking the court to create a constructive trust around the windpower inc. shares, and asking for Willard to reimburse or compensate the trust personally for the previous years of unauthorized compensation.

END OF EXAM