

Question 9 – February 2016 – Selected Answer 1

1. Yes, Tom and Carla breached their duties as co-trustees. Tom can be held personally liable for his breach by engaging in self-dealing, whereas Carla is not liable by virtue of the waiver clause in the original trust agreement. At issue are the duties of trustees as well as potential liability arising from breaches thereof.

Trustees under Texas law are given wide berth with respect to trust property. Nevertheless, they are required to exercise a duty of care with respect thereto. This means that they are expected to act as reasonably prudent individuals would with respect to the trust property. What's more, they are forbidden from engaging in self-dealing or otherwise profiting from their roles as trustees. Failure to either exercise due care or to abstain from self-dealing is a breach for which trustees may be held liable. That being said, a settlor may draft an agreement that waives liability for trustees in the case of negligence.

Here, Tom breached his fiduciary duty to the trust by failing to exercise due care regarding the sports car. In addition, he arguably further breached his duty by misusing trust property for his own benefit. The facts state that the trust was created for the express purpose of protecting and preserving the condition of the rare sports car and paintings. However, Tom frequently used the sports car for his own personal use. This runs counter to the express purpose of the trust, as driving a car contributes to its depreciation. What's more, it risks crashing the car, as happened here. A reasonably prudent person acting in good faith and with due care would not have driven the car given these circumstances. Thus Tom arguably violated his duty of care. What's more, the fact that he engaged in this conduct for his own benefit could be construed as possible self-dealing. While this is admittedly a stretch given the lack of monetary benefit, it is clear that Tom was deriving some type of benefit from using the car -- and doing so despite the risk it posed to the trust property. This could also be deemed a breach of his duty of self-dealing. As Tom's breaches resulted in the destruction of the car, he could be held personally liable for the value of the car. While he might seek cover in the negligence clause of the trust, it arguably would not provide cover to the extent he was deemed to have engaged in self-dealing and intentionally used the trust property for his own benefit. Thus he could be held accountable to Barbara (the beneficiary) for the value of the vehicle.

Carla also breached her duty of care with respect to the trust. Carla failed to pay the rental fee on the storage unit, which resulted in the storage company auctioning off the painting inside. What's more, Carla was aware of Tom's breach in driving the car but did nothing to stop him, to notify the court, or the beneficiary (Barbara) of this breach. Thus she breached her duty of care by failing to protect the corpus of the trust (both the car and the painting) through her own direct negligence with the painting and failing to stop the deliberate acts of Tom with respect to the car. However, unlike Tom, who engaged in self-dealing, Carla may seek cover from the negligence protection afforded in the trust and therefore might not be personally liable for her breaches.

2. Barbara could petition to have both Tom and Carla removed as trustees. Barbara could also sue Tom for the value of the sports car. Finally, Barbara could try to sue Self Store for failing to give notice before seizing the paintings. At issue are what remedies are afforded to a beneficiary of a trust that was mismanaged by its trustees.

As a beneficiary to a trust, Barbara has standing to challenge the handling of a trust by its trustees. In addition, she has interest in the property of the trust and may have a derivative right to sue others who damage that property. As mentioned above, both Tom and Carla breached their duties to the trust and thereby to Barbara as beneficiary for their failures to exercise care and, in the case of Tom, for engaging in self-dealing. At minimum it can be said that they mismanaged the trust, disregarded the terms of the trust, and ultimately contributed to the destruction of the trust property. Given this, Barbara can first petition the court to have both trustees removed. While this would not lead to damages, it would guard against further destruction of the trust property to the extent the trust could continue. If the court found that there was clear and convincing evidence that both Tom and Carla (or either) engaged in mismanagement and misfeasance the court could remove them ex parte and without a hearing. Absent clear and convincing evidence, a hearing would have to be held before they could be removed.

Barbara could next sue Tom personally for his egregious conduct in driving the car and getting into a car accident. While it is not clear whether Tom or the other driver was at fault, Tom nevertheless breached the terms of the trust by failing to protect and preserve the condition and by failing to exercise care and engage in self-dealing as discussed above. As the beneficiary of the trust for which Tom was a trustee, Barbara would have standing to sue him for these losses.

Barbara could also sue Carla for loss of the painting, which was due to her failure to exercise care. However, to the extent this was the result of her negligence and the provision of the trust regarding liability for negligence is valid, Carla's claim would be barred.

Finally, Barbara could attempt to sue the storage company for failing to give proper notice prior to seizing the painting. It does not seem from the facts that Barbara was a party to the storage agreement, however she may attempt to assert a claim on the basis of her third party beneficiary status. For Barbara to have standing as a third party beneficiary, though, she would have to be an intended beneficiary (not incidental), and there is nothing in the facts to suggest that her benefit was contemplated under the storage agreement. Consequently, she likely does not have standing to sue thereunder. However, she might have a claim against Sue and/or Tom if they fail to pursue this action against the storage facility and the facility is in the wrong. Failing to pursue the claim against the facility could be deemed another breach for failure to exercise care to preserve the property of the trust.

Before analyzing the liabilities of the trustees we should establish that there is a valid trust: (1) assets set aside for trust, (2) language indicating a trust was intended, (3) beneficiary named, (4) not an illegal or impermissible use of a trust. There is a valid trust. Trustees do not have to be named but they were named in this case. Secondly, as trustees, Tom and Carla both owe a duty of a reasonably prudent person when it comes to the trust. Which means if the trust incurs a loss or some damage is done to the trust and it was Tom or Carla's fault but in that situation a reasonably prudent person would have done the same thing. Then they would be excused from liability.

(1) Did Tom and Carla breach any of their duties as Co-trustees under Texas law, and, if so, are they personally liable for any such breach? Explain fully.

As trustees Tom and Carla both breached their duties as Co-trustees and are personally liable for the breach in duty to the trust. Their responsibility was to act as any reasonably prudent person would act under the circumstances. Here they acted beyond the scope of a reasonably prudent person.

Tom took the sport cars out for joy rides for his own personal use, which is NOT something a reasonably prudent person would do. As Carla indicated, Tom took a "huge risk" by driving the sports cars. This led to the accident, which is beyond the scope of ordinary negligence and means that Tom is personally liable to the trust. Carla, as co-trustee should have stopped Tom or found a way to stop him. Carla could have gone to court petition to have Tom removed as trustee for his mismanagement of the trust assets to the point it could be considered self-dealing. Typically in self-dealing cases, we see a trustee syphoning off funds from trust for his own personal use. Here we have an analogous case, where Tom is taking the trust assets for his own use (out for rides), each time he takes the car out the value depreciates and he takes a gamble on the condition of the asset. As can be seen with the sports car accident, whether or not it was his fault, the fact that he took a "huge risk" on taking them out for a ride means he has breached his duty of care. A reasonably prudent person would not have taken the cars out and would not have got into an accident.

Carla rented the storage spaces for the paintings herself and she knew of her responsibilities and her duty to make regular payments on the storage unit. Yet she let it lapse. While she may have a defense that the agreement was violated by Self Store, it was her responsibility to keep the payments going. Self store breached its contract by not giving notice to the renter (Carla and the trust) but that does not alleviate Carla's duty of care to keep making the payments on time. A reasonably prudent person would have made timely payments to prevent the possibility of an auction happening in the first place.

While both Tom and Carla may try and rely on the "Co-Trustees are released from liability for any negligent acts" clause in the trust. However, that clause is unenforceable in Texas and won't be of any help to the trustees.

(2) What claims and remedies does Barbara have as beneficiary under Texas Law, and does she have standing to assert them? Explain fully.

Barbara, while a minor, is also beneficiary of the trust and therefore has standing to petition the court for the removal of the trustees for gross mismanagement of trust assets. Tom in destroying a sports car and Carla for losing the paintings. The trustees' failure to uphold their reasonably prudent person standard of duty of care to the trust resulted in huge losses for the trust. Barbara also has standing to file a personal tort suit of conversion towards the trustees. The trust will reimburse Barbara's costs for the tort suit if she sees fit to file it. Tommy assert that it was not his fault on the car accident, but the fact that he took the trust assets out for his own use is a breach of duty to the trust and a case of self dealing. Carla while not self-dealing, breached her duty when she did not act as a reasonably prudent person would in keeping the payments up with Self-Store. She will claim that Self-Store breached the contract for not providing notice, it was only because she failed to make the rental fee.

As beneficiary, Barbara has standing for both the actions above. If the court sees fit they could remove the trustees and appoint new trustees for the trust, because a trust would never fail for the lack of a trustee.

Question 9 – February 2016 – Selected Answer 3

1. Tom and Carla breached their fiduciary duties as trustees and they will be personally liable to Barbara.

The issues is whether Tom and Carla, as trustees of an irrevocable trust for the benefit of Barbara, breached their fiduciary duties to Carla by failing to care for trust property. Under Texas law, a trust requires intent by a settlor to create a trust, an identifiable beneficiary, and the transfer of title to the property constituting trust corpus. In this case, Scott clearly established a valid trust for the benefit of his minor daughter Barbara.

When Tom and Carla became trustees of the trust, they immediately owed fiduciary duties of care and loyalty to Barbara, as beneficiary of the trust. Under Texas law, a trustee must act for the sole benefit of the trust beneficiary. In doing so, the trustee is guided by a variety of specific duties. First, a trustee owes the beneficiary a duty of care. This means the trustee must act like a reasonable, prudent person under the circumstances, taking into account any special skills or knowledge the trustee may have. This duty of care is broad and encompasses a variety of other duties. For example, a trustee must prudently invest trust assets on behalf of the beneficiary to increase the value of the trust (i.e. the prudent investor rule). The trustee must also diversify trust assets to protect the beneficiary from loss of trust assets. A trustee must also earmark trust assets, and not commingle trust assets with the trustee's personal assets. Finally, a trustee has a duty to safeguard trust property.

Second, a trustee owes the beneficiary a duty of loyalty. This duty requires the trustee to act solely for the best interest of the beneficiary. As such, the trustee must avoid conflicts of interests, self-dealing, and any transaction in which the trustee has an interest, or transactions in which people close to the trustee have an interest (i.e. the trustee's family or significant other).

In the present case, Both Tom and Carla breached their fiduciary duties to Carla when they failed to safeguard trust assets. Since the trust corpus was composed of expensive sports cars and expensive paintings, the trustees had a duty to exercise reasonable care to protect and preserve these assets. Moreover, as settlor of the trust, Scott's express purpose for the trust was to protect and preserve the rare sports cars and paintings. Tom and Carla's actions clearly violated this purpose as well as their fiduciary duties.

Tom breached this duty by using the exotic cars, which are trust property, for his personal use. A reasonable, prudent person would not use expensive and exotic cars for personal use, especially when those cars are assets in a trust specifically held for the benefit of another person. Tom's imprudence is clearly indicated by the fact that he wrecked one of the cars held in trust for Barbara. Tom's conduct is, at best, negligent and perhaps even reckless. Moreover, Tom arguable breached his duty of loyalty to Barbara because Tom used trust assets for his own benefit, instead of ensuring the assets were maintained for Barbara's benefit.

Carla also breached her duty of care when she decided to store expensive paintings held in trust for another at an ordinary storage unit. A reasonable and prudent person would believe this is an appropriate method of safeguarding expensive paintings. Carla also breached her duty of care by failing to pay the storage unit rental fees. Carla's failure resulted in the paintings being auctioned off, which likely created a huge loss for the trust. Furthermore, Carla breached her duty of loyalty to Barbara by failing to take action when she learned that Tom used cars owned by the trust for his own benefit. Under Texas law, when a co-trustee commits misconduct or breaches his duties, the other trustee has a duty to prevent further misconduct and file an action in court to have the other trustee removed. Here, however, Barbara merely made a verbal remark regarding "a huge risk" and failed to take any further action. Barbara's failure to protect trust property and to act on behalf of Barbara is not only unreasonable and imprudent, but also a breach of loyalty to Barbara because Carla failed to take any action to protect the trust property.

Tom and Carla will likely assert that they are protected by the trust's exculpatory clause, which limits liability for negligent acts. Exculpatory clauses are upheld in Texas, however, they are narrowly construed. In this case, Tom's conduct arguably exceeds the bounds of negligence but, more importantly, he also breached his duty of loyalty. Exculpatory clauses will only protect a trustee from a negligent breach of their duty of care. Such a clause will not protect Tom from his duty of loyalty breach.

Likewise, Carla is not protected because she too breached her duty of loyalty by failing to prevent Tom from misusing trust property. Moreover, as with Tom, Carla's acts of storing paintings worth millions of dollars in a storage unit likely constitutes gross negligence or even recklessness. Therefore, the exculpatory clause likely will not protect her from liability with respect to the paintings or her failure to protect the cars from Tom's misuse.

Since Tom and Carla breached their fiduciary duties, and likely will not be protected by the trust's exculpatory clause, they will be personally liable to Barbara for the losses to the trust that resulted from their conduct.

2. The issue is what remedies are available to Barbara and whether she has standing to assert them.

With respect to Barbara's standing, normally a trustee that obeys their duties can bring suit on behalf of a minor beneficiary to protect the beneficiary's interests. Since the trustee in this case caused harm to Barbara, a court would likely appoint a guardian ad litem or an attorney ad litem to represent Barbara's interests and bring a lawsuit on her behalf. Therefore, Barbara, as a trust beneficiary, does have standing to sue Tom and Carla, but a court will require a representative to be appointed to bring suit on behalf of Carla as beneficiary of the trust.

Second, under Texas law when a trustee breaches his fiduciary duties to a beneficiary, the trustee is personally liable. If the trustee's action creates a pecuniary benefit for the trustee at the expense of the trust, that benefit can be held in a constructive trust for the benefit of the trust beneficiary. Here, however, Tom and Carla caused great losses to the trust and received no personal benefits. As such, Barbara's representative can bring a breach of fiduciary duty lawsuit against both Tom and Carla and obtain money judgments against Tom and Carla personally. Those judgments then can be executed or against Tom and Carla's assets to recoup losses to the trust caused by Tom and Carla's conduct.