

Trustees' Ability To Retain And Compensate Attorneys In Texas

By

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Introduction

- Trustees often need to retain counsel to properly manage trusts.
- This issue is often not disputed, but when breach of fiduciary duty claims are asserted against a trustee, the issue can be *very* disputed.
- This presentation discusses several important issues: engagement letters, the attorney-client privilege, co-trustee issues, authority to retain counsel, authority to compensate counsel, paying for counsel in the interim, and injunctive relief.

Engagement Letters



Engagement Letters

- Engagement letters are very important to both a trustee and counsel.
- These are the contracts that set the stage for all future work and disputes.
- The use of properly drafted engagement letters is not only a critical risk management tool, but also forms the foundation of client communication and trust.
- Need different engagement letters for different assignments.

Engagement Letters

- Things to include in letters:
- Identify client (and who is not the client);
- Rates/Fee Arrangement;
- Retainer;
- Who pays bills and retainer;
- Billing and payment;
- Scope of assignment (and limitations);

Engagement Letters

- Multi-party issues;
- Termination;
- Technology/hacking;
- Conflicts of interest and waivers;
- Business conflicts;
- Rules of ethics;
- No guarantee on results or cost; and
- Dispute resolution terms.

Attorney-Client Privilege



Attorney-Client Privilege

- The attorney-client privilege protects from disclosure confidential communications between a client and his or her attorney “made for the purpose of facilitating the rendition of professional legal services to the client” Tex. R. Civ. Evid. 503(b).
- Trustee has no duty to disclose attorney-client communications to beneficiaries. *Huie v. DeShazo*, 922 S.W.2d 920 (Tex. 1996).

Attorney-Client Privilege

- Rule 503(b) protects not only confidential communications between the lawyer and client, but also the discourse among their representatives. Tex. R. Evid. 511(1).
- For example, in *In re Segner*, a trustee hired a consultant to assist in the management of a trust, including supervising employees and assisting with attorneys. 441 S.W.3d 409 (Tex. App.—Dallas 2013, orig. proceeding).
- The court of appeals granted mandamus relief to protect communications with the consultant where the court focused on the consultant’s testimony, that he “sent and reviewed confidential communications with the trust’s attorneys for the purposes of effectuating legal representation for the trust.”

Attorney-Client Privilege

- Co-trustees can jointly retain counsel and can jointly assert attorney-client privilege.
- Their communications with their attorney are privileged as against third parties, such as beneficiaries.
- In *In re Alexander*, No. 14-18-00466-CV, 2019 Tex. App. LEXIS 6474 (Tex. App.—Houston [14th Dist.] July 30, 2019, original proc.), the court granted mandamus relief to protect attorney communications with co-trustees.
- However, if the co-trustees themselves have a dispute, then there is no privilege and the communication between the attorney and either one of the co-trustees is open to discovery by the other co-trustee.

Attorney-Client Privilege

- **Warning:** a trustee should be careful about using advice of counsel as a defense to a claim.
- Advice of counsel is a factor in evaluating a trustee's prudence.
- If a trustee raises advice of counsel as a defense, then the trustee will likely waive attorney-client communication privilege.

Inadvertent Attorney-Client Relationship



Inadvertent Attorney-Client Relationship

- A trustee and its counsel should be careful to appropriately communicate with the beneficiary such that the beneficiary does not believe that he or she is a client of the attorney.
- While it is generally a relationship created by contract, an attorney-client relationship can be implied based on the conduct of the parties.
- To determine whether there was a meeting of the minds, a court uses an objective standard, examining what the parties said and did and do not look at their subjective states of mind.
- A trustee does not generally want to share counsel with a beneficiary.

Authority to Retain Counsel

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Authority to Retain Counsel

- Trustees have the statutory and common-law right to retain attorneys for a variety of matters.
- The first place to look regarding a trustee's right to retain counsel is the trust document itself.
- There are also a number of statutory provisions that allow a trustee to retain counsel.
- Common law would also support a trustee retaining counsel where it is prudent to do so.

Authority To Retain Counsel

- Retaining attorneys can be more complicated with a trust that is administered by co-trustees.
- Co-trustees each owe fiduciary duties, but they should exercise their duties jointly, as a unit.
- The Texas Trust Code provides that, in the absence of trust direction, co-trustees generally act by majority decision. Tex. Prop. Code § 113.085(a).
- A co-trustee has a duty to participate in the performance of a trustee's function. Tex. Prop. Code § 113.085(c).
- Furthermore, “each co-trustee has a duty, and also the right, of active, prudent participation in the performance of all aspects of the trust's administration.” Restatement (Third) of Trusts, § 81.

Authority to Retain Counsel

- For example, in *Conte v. Conte*, the court of appeals affirmed a trial court's order denying a co-trustee's request for reimbursement for attorney's fees. 56 S.W.3d 830 (Tex. App.—Houston [1st Dist.] 2001, no pet.).
- The trust provided that “any decision acted upon shall require unanimous support by all co-trustees then serving,” and the court stated: “[c]learly, Joseph Jr.’s decision to employ counsel to defend against his co-trustee’s declaratory judgment action was not the subject of unanimous support by all co-trustees.”
- The court also noted that the other co-trustee had paid for her attorneys from the trust without the consent of the other co-trustee and noted that this was an issue that the successor trustee or beneficiary could raise in a later proceeding

Compensating Attorneys



Compensating Attorneys

- The first place to look for any power is the trust document itself.
- **Drafting Tip:** Consider broader provisions regarding a trustee retaining counsel and compensating them (consider language for interim payments).
- Trust documents generally do not limit a trustee's power to retain and compensate attorneys.
- The Texas Property Code has several provisions that impact a trustee's power to compensate attorneys.

Compensating Attorneys

- Texas Trust Code Section 113.018 provides that “A trustee may employ attorneys, accountants, agents, including investment agents, and brokers reasonably necessary in the administration of the trust estate.”
- Does this imply a right to compensate?
- One court held that it does not address the conditions for reimbursement of attorney’s fees from the trust estate. *Conte v. Conte*, 56 S.W.3d at 834

Compensating Attorneys

- Note that this provision has an important limitation: “reasonably necessary in the administration of the trust estate.”
- A trustee may breach a duty by paying fees from a trust before this finding is made.
- For example, in *Stone v. King*, the court of appeals affirmed a finding that a trustee breached his fiduciary duties in converting trust property to pay for his attorneys’ fees. No. 13-98-022-CV, 2000 Tex. App. LEXIS 8070, 2000 WL 35729200, at *8 (Tex. App.—Corpus Christi Nov. 30, 2000, pet. denied).

Compensating Attorneys

- Section 114.063 states: “(a) A trustee may discharge or reimburse himself from [the] trust ... for: (1) advances made for the convenience, benefit, or protection of the trust or its property; (2) expenses incurred while administering or protecting the trust or because of the trustee’s holding or owning any of the trust property...”
- This does not specifically address attorneys.
- This does not expressly require necessary or reasonable fees.
- Does this apply just to routine trust administration issues or does it also address litigation where a trustee defends against breach of fiduciary duty claims?

Compensating Attorneys

- Trust Code section 114.064 provides that, “[i]n 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.”
- This does deal with litigation and disputes.
- This does require findings of necessariness and reasonableness by a jury (if requested)
- This does require findings of equitableness and justness by a court.

Compensating Attorneys

- The Texas Property Code does not provide any clear guidance as to how 114.063 and 114.064 work together in the context of defending breach claims.
- Possible theories?
- No clear precedent in Texas on this issue.

Compensating Attorneys

- A trustee, co-trustee, or beneficiary has a right to file a declaratory judgment claim regarding trust administration.
- “In any proceeding under this chapter, the court may award costs and reasonable and necessary attorney’s fees as are equitable and just.” Tex. Civ. Prac. & Rem. Code § 37.009.
- Like the Trust code, this does require findings of necessariness and reasonableness by a jury (if requested)
- Like the Trust code, this does require findings of equitableness and justness by a court.

Compensating Attorneys

- A trustee has the powers recognized by the common law.
- “A trustee is not limited to incurring expenses that are necessary or essential, but may incur expenses that, in the exercise of fiduciary judgment are reasonable and appropriate in carrying out the purposes of the trust, serving the interests of the beneficiaries, and generally performing the functions and responsibilities of the trusteeship.”
Restatement (Third) of Trusts § 88 cmt b.
- *Corpus Christi Bank & Trust v. Roberts*, 597 S.W.2d 752 (Tex. 1980).
- Fairly clear that a trustee has the power to retain and pay attorneys for trust administration issues and to defend trust assets without approval of a court.
- However, the misuse of that discretion could be challenged later by a breach-of-fiduciary-duty claim.

Compensating Attorneys

- Can a trustee pay its attorneys from trust funds in defending against a claim of breach of fiduciary duty?
- The Restatement of Trusts provides: “To the extent the trustee is successful in defending against charges of misconduct, the trustee is normally entitled to indemnification for reasonable attorney’s fees and other costs; to the extent the trustee is found to have committed a breach of trust, indemnification is ordinarily unavailable.” Restatement (Third) of Trusts § 88.
- “Ultimately, however, the matter of the trustee’s indemnification is within the discretion of the trial court, subject to appeal for abuse of that discretion.” *Id.*

Compensation In The Interim



Compensation In The Interim

- If co-trustee management, there must be authority (majority vote) to allow it.
- There is authority that a trustee bringing the claim (policing its co-trustee) should have access to trust assets to pay for that activity.
- “If a trustee needs independent counsel to fulfill these duties, reasonable attorney fees may *be paid or reimbursed* from the trust.” RESTATEMENT at § 81(d).

Compensation In The Interim

- There is very little authority in Texas that is directly on point on whether a defendant/trustee is entitled to compensate attorneys from a trust in defending claims of breach of fiduciary duty in the interim.
- Some authority seems to suggest that a trustee has the ability to do so.
- *In the Guardianship of Hollis*, No. 14-13-00659-CV, 2014 Tex. App. LEXIS 12038 (Tex. App.—Houston [14th Dist.] November 4, 2014, no pet.).

Compensation In The Interim

- Texas cases normally state that a trustee may pay for attorneys in defending a claim of breach if done in good faith and reasonably.
- Can a trustee take money from a trust to pay its attorneys before a finding of good faith or reasonableness?

Compensation In The Interim

- In *In re Nunu*, an estate beneficiary sued the executrix to have her removed and also sought to have the court refuse to pay her attorneys in the interim. No. 14-16-00394-CV, 2017 Tex. App. LEXIS 10306 (Tex. App.—Houston [14th Dist.] November 2, 2017, pet. denied).
- The court held: “There is no such order in the record, and the trial court could not properly have approved payments made before the removal action had been decided. Although Nancy appears to have assumed that she could pay her legal fees without first obtaining findings that the fees were both necessary and reasonable, the statute does not authorize such a procedure.” *Id.*

Compensation In The Interim

- *In re Nunu* is consistent with authority from other jurisdictions that hold that a trustee does not have authority (and a trial court does not have authority) to award attorney's fees from a trust in the interim and before a final decision is made on good faith and merits of the underlying breach-of-fiduciary-duty claim.
- In *Kemp v. Kemp*, an appellate court reversed a trial court's award of attorney's fees to a beneficiary in the interim against a trustee even though the trustee admitted to breaches of fiduciary duty at the hearing. 337 Ga. App. 627, 632 (788 SE2d 517) (2016).

Compensation In The Interim

- In *People Ex Rel Harris v. Shine*, the trustee petitioned for advance fees from the trust for defense of a petition for removal, subject to repayment if the trustee was ultimately found not entitled to indemnity. 224 Cal. Rptr.3d. 380 (2017).
- The court would allow such a payment in some instances and stated: “the grant of interim fees should be governed by the following: the court must first assess the probability that the trustee will ultimately be entitled to reimbursement of attorney fees and then balance the relative harms to all interests involved in the litigation, including the interests of the trust beneficiaries. An assessment of the balance of harms requires at least some inquiry into the ability of the trustee or former trustee to repay fees if ultimately determined not to be entitled to costs of defense.”

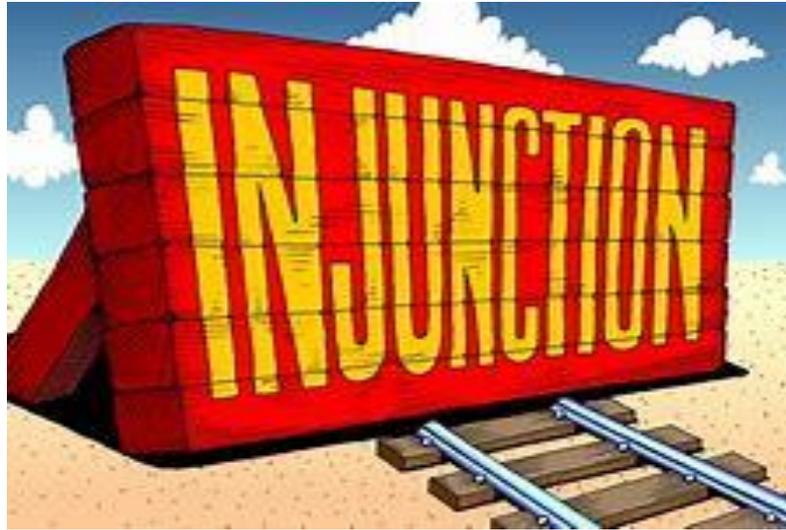
Compensation In The Interim

- Some of these issues were argued in a recent case in Texas.
- In *In re Cousins*, a trustee filed a mandamus proceeding to challenge a trial court's denial of a motion to pay his attorney's fees from the trust. No. 12-18-00104-CV, 2018 Tex. App. LEXIS 3930 (Tex. App.—Tyler May 31, 2018, original proceeding).
- The court did not address the substance of whether Section 114.063 allowed the payment in the interim and denied on procedural grounds.

Compensation In The Interim

- Courts uniformly hold that a trustee is entitled to reimbursement for litigation expenses if the litigation was brought or defended in good faith and benefited the trust.
- If a trustee pays fees before this finding is made, it risks a finding that doing so was a breach of fiduciary duty.
- When a trustee sues a co-trustee or is a defendant in breach of duty case, it should likely not pay fees from the trust in the interim and should wait to seek reimbursement at the conclusion of the litigation.

Injunctive Relief



Injunctive Relief

- This issue may arise in a request for temporary injunctive relief.
- This usually requires a showing of probable right of recovery and an irreparable injury in the interim.
- To show a probable right of recovery, an applicant need not establish that it will finally prevail in the litigation, rather, it must only present some evidence that, under the applicable rules of law, tends to support its cause of action.
- In a fiduciary case, there is authority that the usual burden of establishing a probable right of recovery does not apply if the gist of the complaint is that a fiduciary is guilty of self-dealing.

Injunctive Relief

- Irreparable injury requirement may not apply in a fiduciary case.
- In *183/620 Group Joint Venture v. SPF Joint Venture*, the court of appeals affirmed a temporary injunction prohibiting the defendants from using funds held by them as fiduciaries for the payment of attorney's fees and expenses in defending the breach of fiduciary duty lawsuit. 765 S.W.2d 901 (Tex. App.—Austin 1989, writ dismiss. w.o.j.).
- Where the injunction seeks to restrain a party from expending sums held by them as fiduciaries, the court held that damages would not be an adequate remedy “because the funds will be reduced, pending final hearing, so they will not be available in their entirety, in the interim, for the purposes for which they were delivered to the holder in the first place.”
- Since a breach of fiduciary duty claim is by nature an “equitable” action, even in cases where damages may be sought, if the fiduciary relationship is still continuing, the beneficiary has an equitable right to be protected from further harm.

Injunctive Relief

- In *Zaffirini v. Guerra*, the court of appeals reversed an injunction, holding there was no evidence of irreparable harm: that the trustees could not pay back the money. No. 04-14-00436-CV, 2014 Tex. App. LEXIS 12761 (Tex. App.—San Antonio November 26, 2014, no pet.).
- It disagreed with the *183/620 Group Joint Venture* case.

Conclusion



- A trustee should be careful when compensating attorneys from a trust—this payment should benefit the beneficiaries.
- Otherwise, a trustee may breach duties by compensating attorneys.