

The Use Of Exculpatory Clauses In Trust Documents

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Introduction

- Settlers, trustees, and beneficiaries may want to insert clauses into trusts that benefit the trustee and free the trustee to take certain actions without potential liability.
- A settlor may want to name himself or herself as trustee and have liability protection.
- Beneficiaries may want a trustee to keep a family farm or business as a trust asset and relieve a trustee of certain duties that may interfere with that desire.
- Exculpatory clauses can provide that protection.

Introduction

- These clauses are somewhat controversial in a trust context in that a trustee owes high fiduciary duties to the beneficiary.
- Though these clauses may be generally enforceable in arms-length transactions, are they as readily enforceable in the context of a fiduciary relationship?

Areas Of Discussion

- The areas we will discuss are:
- Exculpatory clause vs. powers clause;
- Historical approach in Texas;
- *Texas Commerce Bank v. Grizzle* opinion;
- New statutory provisions;
- Duty to disclose;
- Impact of clause on other remedies;
- Precedent that is post-statutory amendments; and
- Procedural aspects of litigating such a clause.

Exculpatory Clause: Definitions

- A common, general exculpatory clause may state “The trustee shall be saved harmless from any liability for any action he or she may take, or for the failure of such trustee to take any action, if done in good faith and without gross negligence.”
- Another type of clause relieves a trustee from a particular duty or directs the trustee to do something that might ordinarily be a breach of duty.
- For example, such a clause may state: “The trustee is relieved of the duty to investigate the actions of any prior trustee and has no duty to bring any claim against any prior trustee.”

Exculpatory Clause: Definitions

- “When an exculpatory clause is applied, a breach has occurred, but liability is excused. In contrast, if a powers clause authorizes an act, no breach of fiduciary duty has occurred. Because the act does not result in a breach, the act cannot give rise to any liability. This is the critical difference between powers and exculpatory clauses.”

Exculpatory Clause

- Restatement provides that a clause is enforceable except for (1) acts done in bad faith or with indifference to fiduciary duties, trust terms, or beneficiaries' interests; or (2) profits derived from a breach of trust.
- The Uniform Trust Code has similar provisions.
- In Texas, courts have historically enforced exculpatory clauses, at least to some extent.
- Exculpatory clauses are strictly construed, and a trustee is relieved of liability only to the extent to which it is clearly provided that it will be excused.

History of Exculpatory Clause

- Historically, Texas courts enforced exculpatory clauses, except that courts would not enforce such a clause to relieve a trustee of intentional or bad faith conduct due to public policy concerns.
- Specifically, in *Langford v. Shamburger*, the court held that “it would be contrary to the public policy of this State to permit the language of a trust instrument to authorize self-dealing by a trustee.” 417 S.W.2d 438, 444 (Tex. Civ. App.—Fort Worth 1967, writ ref’d n.r.e.).

History of Exculpatory Clause

- When there were not issues of self-dealing, courts were inclined to enforce the clause.
- In *Corpus Christi National Bank v. Gerdes*, the court of appeals held that an exculpatory clause was not against public policy and was enforceable where the facts of that case did not include self-dealing. 551 S.W.2d 521 (Tex. Civ. App.—Corpus Christi 1977, writ ref'd n.r.e.).
- The court reversed a damage award for beneficiaries, holding: “generally a trustee’s powers are conferred by the instrument and neither the trustee nor the courts can add to or take away from such powers, but must permit it to stand as written and give to it only such construction as the trustor intended.” *Id.*

History of Exculpatory Clause

- *Neuhaus v. Richards*, 846 S.W.2d 70, 74 (Tex. App.—Corpus Christi 1992). Beneficiaries sued the trustee for failing to diversify trust assets and the court of appeals held that exculpatory clause was not effective for “willful misconduct or personal dishonesty.”
- *Jochee v. Clayborne*, 863 S.W.2d 516 (Tex. App.—Austin 1993, writ denied). Beneficiaries sued a trustee for making an interested transaction with an entity with whom she had an ownership interest. Court reversed the jury’s verdict for the beneficiary because the trial court should have instructed the jury that the trustee’s duties were governed by the terms of the trust instrument.

Grizzle Opinion

- In 2002, the Texas Supreme Court revisited exculpatory clauses and held that a trust document could relieve a trustee of liability for even self-interested transactions. *Texas Commerce Bank v. Grizzle*, S.W.3d 240, 249 (Tex. 2002).
- The Court held that “the trust Code authorizes a settlor to exonerate a corporate trustee from almost all liability for self-dealing,” such as misapplying or mishandling trust funds, including failing to promptly reinvest trust monies. *Id.* at 250.
- The Court also held that public policy did not bar such exculpatory clauses: “We disagree with the court of appeals’ conclusion that public policy precludes such a limitation on liability.” *Id.*

Statutory Amendments

- The Texas Supreme Court seemed willing to follow the settlor's intent to forgive even some intentional conduct despite other historic public policy considerations to the contrary.
- In response to *Grizzle*, the Texas Legislature amended the Texas Property Code in 2005, repealed Section 113.059, and added Sections 111.0035 and 114.007.
- The Texas Property Code now limits a settlor's ability to exculpate a trustee.

Statutory Amendments

- 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: (1) breaches done with bad faith, intent, or reckless indifference to the interests of a beneficiary, or (2) for any profit derived by the trustee from a breach of trust. Tex. Prop. Code Ann. § 114.007.

Statutory Amendments

- Section 114.007(a) focuses on a general type of exculpatory clause that provides that a trustee is not liable for any improper action.
- It is important to understand the definitions of bad faith, reckless indifference, and intent to understand what exculpatory clauses do not protect.

Statutory Amendments

- Bad faith is: “The opposite of “good faith,” generally implying or involving actual or constructive fraud, or a design to mislead or deceive another, or a neglect or refusal to fulfill some duty or some contractual obligation, not prompted by an honest mistake as to one’s rights or duties, but by some interested or sinister motive. It has been held that a finding of bad faith requires some showing of an improper motive, and that improper motive is an essential element of bad faith.”

Statutory Amendments

- A fiduciary acts in good faith when he or she: (1) subjectively believes his or her defense is viable, and (2) is reasonable in light of existing law.
- A person acts intentionally, or with intent, with respect to the nature of his conduct or to a result of his conduct when it is his conscious objective or desire to engage in the conduct or cause the result.

Statutory Amendments

- “Gross negligence” means an act or omission:
- (A) which when viewed objectively from the standpoint of the actor at the time of its occurrence involves an extreme degree of risk, considering the probability and magnitude of the potential harm to others; and
- (B) of which the actor has actual, subjective awareness of the risk involved, but nevertheless proceeds with conscious indifference to the rights, safety, or welfare of others.

Statutory Amendments

- Section 114.007(c) provides: “This section applies only to a term of a trust that may otherwise relieve a trustee from liability for a breach of trust. Except as provided in Section 111.0035, this section does not prohibit the settlor, by the terms of the trust, from expressly: (1) relieving the trustee from a duty or restriction imposed by this subtitle or by common law; or (2) directing or permitting the trustee to do or not to do an action that would otherwise violate a duty or restriction imposed by this subtitle or by common law.”

Statutory Amendments

- Section 114.007(c) deals with the second type of clause and deals with specific duties and actions.
- This states that a settlor can relieve a trustee from a specific duty or to allow a trustee to do or not do some action otherwise restricted by law.
- There are no express restrictions regarding bad faith, intentional conduct, or acting with reckless indifference to the beneficiary's interests *or* where the co-trustees acted with or without negligence where the trustee derived a profit.

Statutory Amendments

- Importantly, Section 111.0035 states, in part, that a trust term may not limit a trustee’s “duty to act in good faith and in accordance with the purposes of the trust.”
- There is no statutory exception to this duty of good faith.
- The duty to act in good faith appears to apply at all times to every provision of a trust agreement.

Statutory Amendments

- Section 114.007(c) expressly discusses two types of powers clauses: those that eliminate a duty that generally exists and those that allow a trustee to do some act that ordinarily it cannot do.
- The first type of powers clause (eliminating a duty), would seemingly be enforceable even if the trustee failed to take some act in bad faith. Can a trustee breach a duty, even in bad faith, that the trustee does not owe?
- The second type of powers clause is the type that allows a trustee to do something that it ordinarily cannot do, and it would seem that the trustee would have to exercise that power in good faith.

Statutory Amendments

- The Texas Trust Code provides: “A term in a trust instrument relieving the trustee of liability for a breach of trust is ineffective to the extent that the term is inserted in the trust instrument as a result of an abuse by the trustee of a fiduciary duty to or confidential relationship with the settlor.”
- So, there are circumstances where a trustee cannot rely on an exculpatory clause that the trustee inserted due to an improper act.

Duty to Disclose

- Where a trustee breaches a duty, but is not liable in damages due to an exculpatory clause, does the trustee have a duty to disclose that conduct to a beneficiary?
- What if the trustee uses a powers clause right?
- A trustee has a duty of full disclosure of all material facts known to it that might affect the beneficiaries' rights.
- Prudence would dictate to disclose.
- *Grizzle* opinion may provide protection for failure to disclose.

Exculpatory Clause And Other Remedies

- There is an argument that exculpatory clauses that relieve a trustee from liability (but not breach) may not prevent a beneficiary from seeking non-monetary relief.
- For example, a plaintiff may seek the removal of the trustee, enjoining the trustee from committing an improper act, or the denial or reduction of the trustee's compensation.
- Powers clause, however, means that there is no breach, so other remedies may not be available.

Post-Amendment Precedent

- *Dolan v. Dolan*, No. 01-07-00694-CV, 2009 Tex. App. LEXIS 4487 (Tex. App.—Houston [1st Dist.] June 18, 2009, pet. denied). Court found that an exculpatory clause did not protect a trustee where invested trust funds into his own needlepoint business.
- *Martin v. Martin*, 363 S.W.3d 221 (Tex. App.—Texarkana 2012, pet. denied). Court noted that the new statutory provisions reversed *Grizzle* and found that an exculpatory clause did not protect the trustee from actions where he had a conflict of interest.
- *Wells Fargo v. Militello*, No. 05-15-01252-CV, 2017 Tex. App. LEXIS 5640 (Tex. App.—Dallas June 20, 2017, no pet.). Court held that exculpatory clause did not protect trustee that acted with gross negligence/reckless indifference.

Post-Amendment Precedent

- *Kohlhausen v. Baxendale*, No. 01-15-00901-CV, 2018 Tex. App. LEXIS 1828 (Tex. App.—Houston [1st Dist.] March 13, 2018, no pet.). The court affirmed a summary judgment for a trustee on the basis of an exculpatory clause where the non-movant beneficiary did not prove bad faith.
- *Goughnour v. Patterson*, No. 12-17-00234-CV, 2019 Tex. App. LEXIS 1665 (Tex. App.—Tyler March 5, 2019, pet. denied). The court affirmed a summary judgment for a trustee on the basis of an exculpatory clause where trustee proved good faith via evidence, which was not rebutted.

Post-Amendment Precedent

- *In re Estate of Bryant*, No. 07-18-00429-CV, 2020 Tex. App. LEXIS 2131 (Tex. App.—Amarillo March 11, 2020, no pet.). Court affirmed trial court's refusal to apply exculpatory clause where trustee's advice of counsel defense was meritless due to the trustee providing inadequate facts to his counsel.
- *Benge v. Roberts*, No. 03-19-00719-CV, 2020 Tex. App. LEXIS 6335 (Tex. App.—Austin August 12, 2020, no pet.). Court affirmed summary judgment for trustee where powers clause eliminated the trustee's duty to investigate prior trustees.

Procedural Issues

- Affirmative defense vs. inferential rebuttals
- Pleading requirement
- Summary judgment burdens and availability of no-evidence summary judgment
- Burden of proof at trial
- Submission in charge
- Advice of counsel defense and waiver of attorney client privilege

Conclusion

- There are many legitimate reasons for a settlor and trustee to include an exculpatory clause in a trust document.
- These types of clauses are enforced in arms-length transactions, and they can be enforced in trust situations.
- Due to the nature of the trust relationship, there are some additional considerations at play in enforcing these clauses.