DRAFTING TO AVOID LITIGATION: FROM A LITIGATOR'S PERSPECTIVE[1]

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She has been repeatedly selected as a Texas Super Lawyer and before that a Texas Rising Star by Texas Monthly Magazine, including as One of the Top 50 Female Texas Super Lawyers and One as the Top 100 Houston Super Lawyers. She has also been named a Top Lawyer in Houston, one of the Best Lawyers Under 40 by H Texas Magazine, and as a Top Lawyer in Houston by Houston Magazine. And, she has been selected as one of The Best Lawyers in America in the practice areas of Trusts and Estates annually since 2006 and Litigation – Trusts & Estates annually since 2012. In 2014, she has been named as Best Lawyers' 2014 Houston Litigation - Trusts and Estates "Lawyer of the Year."

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I. SCOPE OF ARTICLE: THERE IS NO PERFECT PLAN.

In a perfect world, a successful estate plan would be as simple as a well-drafted will and ancillary documents. When that perfect is put into effect, our client would never lose the required mental capacity to manage his or her personal and financial matters or, if our client subsequently became incapacitated, ancillary documents would allow a trustworthy agent the ability to handle such matters. Likewise, no child or family member would ever interfere with the management of the client's assets, seek a guardianship to undermine the client's agent's authority to act on the client's behalf, challenge the client's will after his or her death, or interfere with a fiduciary's actions unless the fiduciary had *truly* abused his or her powers. Also, in that perfect world, congress would either repeal all estate taxes or never enact changes that would affect our estate plan.

Needless to say, we do not live in a perfect world! As estate plans become more complicated the opportunity for interlopers increases. It is no longer acceptable to wait until a client's death to fight over his or her remaining estate. While will contests are still a concern, interference by interlopers during a client's lifetime continues to increase. A disgruntled child may seek a guardianship to prevent an agent from managing the parent's assets. An agent acting pursuant to a power of attorney could utilize the document to close a right of survivorship account and, as a result, preclude an intended beneficiary from receiving such assets. Likewise, the appointment of a guardian can void various ancillary documents and lead to the loss of a client's privacy and increased expense to the client's estate.

In recent times, estate planners are faced with creating an estate plan that (i) balances a client's current desires relating to the management of his or her property both during lifetime and after death, (ii) provides for the ultimate disposition to the selected beneficiaries, (iii) reduces or avoids transfer taxes, (iv) provides enough protection for fiduciaries to allow them to do their job but still requires them to do it correctly, and (v) creates disincentives to beneficiaries and third parties to impede with the plan. If that was not enough, recent legislative changes in the death tax system and rumored additional changes require the plans to be flexible enough to allow clients to take advantage of yet to be decided tax opportunities.

Finally, America's senior population continues to increase. It is estimated that by 2030, there will be about 70 million persons over the age of 65: more than twice the number in 2000. Persons over the age of 65 represented approximately 12.4% of the population in the year 2000, but are expected to increase to approximately 20% of the population by 2030. See Administration on Aging, Profile of Older Americans: 2002, http://www.aoa.dhhs.gov/aoa/stats/profile/2.html. Unfortunately, the increase in a client's age also increases the likelihood of encountering legal and ethical issues and challenges arising from a client's questionable capacity.

This outline focuses on the non-tax advantages, disadvantages and issues related to the engagement and subsequent formulation of a client's estate plan that is intended to reduce challenges and interference. The outline includes a discussion of initial considerations and capacity requirements. It also reviews various estate planning options including wills, trusts, partnerships, and ancillary documents, and related provisions relating to flexibility and control. Finally, the outline includes suggestions on ways to plan for a client's future incapacity.

All references to sections refer to the Texas Estates Code unless otherwise noted.

II. INITIAL CONSIDERATIONS.

A. The Engagement.

1. Evaluate Potential Engagement.

It is rumored that Abraham Lincoln gave the following advice to a new lawyer upon passing the bar, "*Young man, it's more important to know what cases not to take than*

it is to know the law." Jay G. Foonberg, HOW TO START AND BUILD A LAW Practice (3d. 1991) at 135. Unfortunately, neither President Lincoln or anyone else can advise an attorney which clients, or cases, should be taken. Rather, it is a product of the attorney's legal education, practical experience, intuition, and sometimes moral and ethical beliefs. Each case must be evaluated based on the facts and circumstances of that particular proposed representation. A few suggestions regarding evaluating a proposed engagement follow.

a. Consider Potential Conflicts of Interest.

The Texas Disciplinary Rules of Professional Conduct provide that an attorney should not represent individuals who have material conflicts of interest. *See* TEX. R. DISCIPLINARY P. 1.06, *reprinted in* TEX. GOV'T CODE ANN., tit. 2, subtit. G app. (Vernon Supp. 2002). Alleged conflicts of interest are generally raised when an attorney represents both a husband and a wife, or other joint clients, in the estate-planning context.

While potential conflicts of interest do not prohibit all joint representations, it is necessary to evaluate the potential conflicts and the nature, implications and possible consequences of the joint representation before agreeing to the joint engagement. When one client has questionable capacity, additional attention should be given to potential conflicts of interest. Even if the client has capacity to execute estate-planning documents, he or she may not arguably have capacity to waive potential conflicts of interest.

Furthermore, if the advisor represents one or more of the intended beneficiaries, the other client may face claims of undue influence or utilizing their attorney to encourage the client with questionable capacity to execute estate-planning documents. In such a case, both clients may benefit from retaining separate attorneys. Remember, the relationship of the client, beneficiary and advisor will be later viewed objectively and a client's advisors should make efforts to reduce (if not avoid) the perception that any conflicts existed or there was even the opportunity for influence.

b. Assess Legal Competency.

Rule 1.01 of the Texas Disciplinary Rules of Professional Conduct provides that an attorney may not accept or continue the representation, which the attorney knows or should know, is beyond his or her legal competence. When determining whether a matter is beyond an attorney's competence, the practice area of the underlying representation is not the only issue. Relevant factors include the complexity of the particular case, the lawyer's experience in addressing the facts of that particular case, the time the lawyer is available to address the issues, and the attorney's experience in handling issues raised by such representation.

Furthermore, while a lawyer may be technically competent to handle the proposed engagement, the lawyer may determine that the proposed client's needs could be better served by referring the potential client to another attorney who has dealt with the specific issues and complexities that may be raised during the representation. An attorney does not violate the Rules of Ethics, however, if he or she associates with another attorney for purposes of gaining additional knowledge or expertise with regard to the client's specific issues, provided, the client's representation can be carried out in a competent manner upon receiving such additional advice. *See* TEX. R. DISCIPLINARY P. 1.01(a), *reprinted in* TEX. GOV'T CODE ANN., tit. 2, subtit. G app. (Vernon Supp. 2002).

c. Assess Litigation Risks.

Some cases involve greater litigation risks than others. Warning signs of a potential challenge may include:

- Unusual disposition of estate;
- Disparate wealth between spouses;
- Excluding spouse as beneficiary;
- Marital problems;
- Second, etc., marriages;
- Children from prior marriages;

- Estranged children or family members;
- Unequal treatment of children;
- Non-traditional relationships;
- Re-involvement by a previously estranged family member;
- Beneficiaries with drug, alcohol or other dependencies;
- Elderly client or clients;
- Ill clients or those who have suffered a significant medical episode;
- Client's formation of a recent relationship with an intended beneficiary;
- Nonstandard involvement by an intended beneficiary; and
- Existing or anticipated family conflict.

While the preceding is not intended to be a complete list, these situations are often a precursor to future litigation. While every estate plan inherently requires that the lawyer, on some level, become a witness to the proposed estate planning representation, some representations are more complex than others. An attorney is not under an ethical obligation to accept every requested engagement. It is appropriate for an attorney to consider whether the proposed engagement will result in him or her becoming an unwilling witness in, or party to, future litigation.

Furthermore, in all estate planning situations, but particularly in engagements that have a higher risk of being challenged, the advisor should take additional steps to protect the client's objectives. For example, third parties may appear to be influencing the potential client and attempt to advise the attorney how the proposed client wishes to leave his or her property. If the potential client is not willing to meet without these third parties present, the lawyer should strongly consider declining the engagement. To do otherwise, may place the lawyer in a situation of being a party to an alleged conspiracy scheme or interference claims with the third parties.

2. Fee Agreement.

As with any representation, a fee agreement can provide both protection to the attorney and be beneficial to the client. The fee agreement should set out the scope of the engagement. It may also confirm certain facts provided by the client. Finally, if the client's documents may be subject to future challenge, it can provide a means for the attorney to be paid for his or her time relating to protecting the client's privileges, testifying, and related involvement in future litigation. An attorney should not, however, charge more that his standard hourly rate for such matters to avoid the implication that he or she may gain a financial advantage in the event of litigation.

B. Applicable Standards of Capacity.

A client's capacity is a prerequisite to a successful estate plan. Thus, an advisor should understand the required level of capacity to enter into the contemplated transactions. To date, Texas courts have not adopted a single, bright-line test to determine whether an individual has capacity to engage in certain transactions. Rather, the applicable standard of capacity or incapacity is dependent on the specific facts or transactions contemplated by the individual. Thus, an individual may have capacity to engage in certain transactions, but not others. In any estate planning engagement, the advisors involved should be able to recognize and understand the varying levels of capacity. The most frequently encountered standards of capacity required in estate planning and probate transactions are discussed below.

1. Mental or Transactional Capacity.

In Texas, a person has "mental capacity" to contract if, at the time of contracting, he "appreciated the effect of what [he] was doing and understood the nature and consequences of [his] acts and the business [he] was transacting." *Mandell & Wright v. Thomas*, 441 S.W.2d 841, 845 (Tex. 1969); *see also Bach v. Hudson*, 596 S.W.2d 673, 675-76 (Tex.Civ.App.--Corpus Christi 1980, no writ); *Board of Regents of the Univ. of Tex. v. Yarbrough*, 470 S.W.2d 86, 90 (Tex.Civ.App.--Waco 1971, writ ref'd n.r.e.).

The requisite mental capacity depends on the contemplated transaction. A client may have sufficient capacity to enter into certain contracts, agreements, etc., but not others. Mental capacity, or a lack thereof, may be shown by circumstantial evidence, including:

- a person's outward conduct, "manifesting an inward and causing condition;"
- any pre-existing external circumstances tending to produce a special mental condition; and
- the prior or subsequent existence of a mental condition from which a person's mental capacity (or incapacity) at the time in question may be inferred.

See Bach, 596 S.W.2d at 676.

The question of whether a person, at the time of contracting, knows or understands the nature and consequences of his actions is generally an issue of fact for the jury. *See Fox v. Lewis*, 344 S.W.2d 731, 739 (Tex.Civ.App.--Austin 1961, writ ref'd n.r.e.). However, allegations that a person is merely nervous, appears tense or anxious, or has personal problems, is not sufficient to raise a fact issue as to whether a person lacked capacity. *See Schmaltz v. Walder*, 566 S.W.2d 81, 83 (Tex.Civ.App.--Corpus Christi 1978, writ ref'd n.r.e.); *Mandell & Wright v. Thomas*, 441 S.W.2d 841, 845 (Tex. 1969). Rather, relevant evidence may include "evidence of prior actions, conduct, utterances, and transactions of a person whose mental capacity is in question." *Bach*, 596 S.W.2d at 677 (*citing Miguez v. Miguez*, 221 S.W.2d 293, 295-96 (Tex.Civ.App.--Beaumont 1949, no writ); *Carr v. Radkey*, 393 S.W.2d 806 (Tex. 1965); *Buhidar v. Abernathy*, 541 S.W.2d 648, 651 (Tex.Civ.App.--Corpus Christi 1976, writ ref'd n. r. e.)).

2. Testamentary Capacity.

Section 251.001of the Texas Estates Code mandates that the test for testamentary capacity includes the requirement that the testator be of "sound mind." Tex. ESTATES ANN. § 251.001 (Vernon 2014). Sound mind is referred to both commonly and in Texas case law as testamentary capacity even though Section 251.001 does impose other requirements. The sound mind element of testamentary capacity means that at the time the testator signs the will, he or she has sufficient mental capacity to:

- *understand* the business in which he or she is engaged;
- *know* the general nature and extent of his or her property;
- *understand* the effect of the act of making a will;
- *know* the persons to whom he or she wishes to give their property to and the persons dependent upon him or her for support; and
- collect in his or her mind the elements of business to be transacted in executing the will and hold them long enough to perceive their obvious relationship to each other and to form a reasonable judgment about them.

See Tieken v. Midwestern State Univ., 912 S.W.2d 878 (Tex.App.—Fort Worth 1995, no writ) (emphasis added) (*citing Prather v. McClelland*, 13 S.W. 543, 546 (Tex. 1890)); *see also McNaley v. Sealy*, 122 S.W.2d 330 (Tex.Civ.App.—Austin 1938, writ dism'd); *Horton v. Horton*, 965 S.W.2d 78, 85 (Tex.App.—Fort Worth 1998, no writ) (courts generally limit evidence regarding testator's capacity to time period surrounding will execution).

It is generally accepted that less mental capacity is required to make a valid will than to make a valid contract. *See Rudersdorf v. Bowers*, 112 S.W.2d 784 (Tex.Civ.App.—Galveston 1937, writ dism'd w.o.j.); *Hamill v. Brashear*, 513 S.W.2d 602 (Tex.Civ.App.—Amarillo 1974, writ ref'd n.r.e.). The tests regarding capacity to contract are generally not applied in determining the question of testamentary capacity. *See Venner v. Layton*, 244 S.W.2d 852 (Tex.Civ.App.—Dallas 1951, writ ref'd n.r.e.). There remains some authority, however, suggesting otherwise. A few Texas courts have held that the legal standards for determining the existence of mental capacity for purposes of executing a

will are substantially the same as the mental capacity for executing a contract. *Bach v. Hudson*, 596 S.W.2d 673 (Tex.Civ.App.—Corpus Christi 1980) (discussed *supra*).

The issue of whether a person has testamentary capacity is usually a question of fact. *See Smith v. Welch*, 285 S.W.2d 823 (Tex.Civ.App.—Texarkana 1955, writ ref'd n.r.e.). No particular standard is prescribed. *See Farmer v. Dodson*, 326 S.W.2d 57 (Tex.Civ.App.—Dallas 1959); *see also Brown v. Mitchell*, 12 S.W. 606 (Tex. 1889); *Garrison v. Blanton*, 48 Tex. 299 (1877); *Wilson v. Estate of Wilson*, 593 S.W.2d 789 (Tex.Civ.App.—Dallas 1979); *Anderson v. Clingingsmith*, 369 S.W.2d 634 (Tex.Civ. App.—Fort Worth 1963, writ ref'd n.r.e.); *Nowlin v. Trottman*, 348 S.W.2d 169 (Tex.Civ.App.—Amarillo 1961, writ ref'd n.r.e.); *Green v. Dickson*, 208 S.W.2d 119 (Tex.Civ.App.—Galveston 1948, writ ref'd n.r.e.).

It is notable that although lack of testamentary capacity may appear to imply lack of intelligent mental power, it is not necessary for a person to be highly intelligent to dispose of his or her property by will. *See Bell v. Bell*, 237 S.W.2d 688 (Tex.Civ.App.—Amarillo 1951, no writ); *Lowery v. Saunders*, 666 S.W.2d 226 (Tex.Civ.App.—San Antonio 1984, writ ref'd n.r.e.). Rather, lack of education or proof of illiteracy has little, if any, bearing on mental capacity to make a will. *Oliver v. Williams*, 381 S.W.2d 703 (Tex.Civ.App.—Corpus Christi 1964, no writ).

3. Incapacity for Purposes of a Guardianship.

For guardianship purposes, Section 1002.017 of the Texas Estates Code defines an incapacitated person to including the following:

a. a minor;
b. an adult who, because of a physical or mental condition, is substantially unable to:
    1. provide food, clothing, or shelter for himself or herself;
    2. care for the person's own physical health; or
    3. manage the person's own financial affairs; or
    4. a person who must have a guardian appointed for the person to receive funds due the person from a governmental source.

TEX. ESTATES CODE ANN. § 1002.017 (Vernon 2014).

Evidence of a physical or mental condition must be based on reoccurring acts or occurrences within the preceding six (6) month period and not based on a single action or occurrence. *See* TEX. ESTATES CODE ANN § 1101.102 (Vernon 2014).

4. Warning Signs.

It is wise for all estate planning advisors to be aware of potential warning signs during the initial telephone call or meeting with a potential client. These warning signs may indicate incapacity or another disability that could affect either the representation or basis for the representation. Unfortunately, there is not a definitive list of warning signs. A listing of some potential warning signs that might require future inquiry, the cancellation of a contract, or even the notification of a court under the State Bar Disciplinary Rules is included below. *See* TEX. R. DISCIPLINARY P. 1.02(a) and 1.02(g), *reprinted* in TEX. GOV'T. CODE ANN., tit. 2, subtit G. app. (Vernon Supp. 2002). Potential warning signs may include:

- Memory problems evidenced by excessive reliance on third parties to provide basic information;
- Tendency to avoid answering questions that relate to memory recall;
- Covering, i.e. answers a question with responses like: everyone knows that, or glib answers;
- Repeated conversations regarding the same issues or concerns that have been previously responded to;
- Unusual reliance on another person for their basic daily needs such as food,

shelter, clothing, and communication needs;
- Obsessive/compulsive behavior;
- Victim-like behavior, such as the inability to ever perceive the contribution of one's own actions to the current situation;
- Significant mood swings in short periods making rational decisions difficult;
- Unreasonable suspicions, such as that a family member is an enemy, stealing money, or is trying to kill without any factual or logical basis;
- Manic/depressive behavior, such as behaving extremely jubilant for no reason at a serious time, or becoming suddenly depressed, sad and tearful;
- Obsession for revenge;
- Substance abuse disorders to the degree that communication is limited to days when the client has not abused the substance to the degree they are incoherent;
- Mental retardation, to the degree that the person possesses a certain level of understanding, but not necessarily the ability to contract;
- Major depression to the degree there are changes in appetite, sleep patterns, energy, concentration, and possibly feelings of hopelessness and suicidal thoughts;
- Schizophrenia or schizophrenia affective disorders which, when not controlled, result in delusions, disorganized speech, and possibly hallucinations;
- Amnesic disorders that are difficult to address such as fluctuating dementia and dementia of Alzheimer's type; and
- Psychopharmacological disorders such that the client is non-compliant with medications, over-medicates, or abuses both prescribed and over-the-counter medications.

Attorneys are often placed in a difficult position when trying to ascertain the capacity of a client. An attorney may witness some or many of these traits yet are hesitant to "play doctor." Additionally, the questions involved in attempting to "test" the potential clients can prove to be both insulting and embarrassing to the potential client. *See* discussion *infra*. Thus, handling the issue becomes one of instinct and is based on the specific facts at each case. It is, however, often difficult to determine whether the person may lack capacity or is just eccentric.

5. Effect of Determination of Lack of Capacity.

If it is determined that a contract was "executed by a person who does not have the mental capacity to contract, the contract is voidable; and if such person signed a contract without sufficient mental capacity to understand the nature and consequences thereof, the contract is not binding and may be set aside." *See Schmaltz v. Walder*, 566 S.W.2d 81, 83 (Tex.Civ.App.--Corpus Christi 1978, writ ref'd n.r.e.). A determination that a will was executed at a time the testator lacked capacity will result in its failure to be admitted to probate. *See* discussion *supra*.

6. Undue Influence.

While a person may have the capacity to execute documents, their free will may be compromised. A *Prima facie* evidence to invalidate a transaction on the ground of undue influence is made considering the following factors:

a. the susceptibility of the testator to influence, and
b. the opportunity and disposition of the person allegedly exerting undue influence indicating that undue influence was exerted.

Solicitation, importunity, flattery, over-persuasion and fraud or misrepresentation were sufficient to establish undue influence.

Red flags when assessing an undue influence issue include:
- Frail or bad health;
- Dependency on others;
- Ability to write and accurately complete a check;
- Reclusive behavior;

- Isolation. It is just the client and the 24-hour caregivers who are instructed to keep track of phone calls and visitors. Need for a log;
- Child or other relative increasingly dependent on the client;
- New found love;
- Depression;
- Deviation from a long-term gift or an estate plan that was in place for a significant time period;
- Self-medicate or dependent on others to take proper dosages;
- Does the client drive;
- Do they select their own clothing;
- Do they remember meeting you at your previous meetings; and
- Huge age difference.

C. Evaluating Capacity to Engage in Underlying Transaction.

It is advisable to personally meet a potential estate-planning client before agreeing to the proposed representation. This face-to-face meeting is particularly important when capacity may be an issue or the decisions of the client may be challenged. Although not doctors, attorneys are under ethical obligations to at least make a good faith effort to determine if the client has the requisite capacity to retain counsel. Also, when the prospective client is or has been subject to a guardianship proceeding, an adjudication of incapacity can have a significant impact on a person's ability to engage in the underlying transaction.

1. When Presumption of Capacity Exists.

Generally, mental capacity is determined at the time the document at issue is executed or the person enters into a transaction. Therefore, unless a person has been adjudicated to be incapacitated when the attorney is retained, the trust was created, the will was executed, etc., the law presumes sufficient mental capacity to enter into the transaction. *See Estate of Galland v. Rosenberg*, 630 S.W.2d 294, 297 (Tex.Civ.App.--Houston [14th Dist.] 1981, writ ref'd n.r.e.). The presumption of capacity may, however, be overcome with relevant and credible evidence. *See* discussion *supra*.

2. When Presumption of Incapacity Exists.

An adjudication of the testator's incapacity prior to the execution of a will is typically admissible on the issue of the testator's mental capacity. *See Haile v. Holtzclaw*, 414 S.W.2d 916 (Tex. 1967). When the adjudication remains in effect on the date the will was executed, the testator will generally be presumed to lack testamentary capacity. *See Bogel v. White*, 168 S.W.2d 309 (Tex.Civ.App.—Galveston 1942, writ ref'd). This presumption may be overcome by evidence of testamentary capacity. *Id.* at 311.

On the other hand, an adjudication that a person was totally or partially incapacitated entered *after* the date of the will is generally not admissible as evidence on the question of testamentary capacity. *See Carr v. Radkey*, 393 S.W.2d 806 (Tex. 1965). For example, in *Stephen v. Coleman*, the testator signed his will three days before being adjudicated incompetent. The subsequent adjudication did not raise any presumption of lack of testamentary capacity. *See Stephen v. Coleman*, 533 S.W.2d 444 (Tex.Civ.App.—Fort Worth 1976, writ ref'd n.r.e.).

The determination of incapacity does not, however, automatically result in a person lacking sufficient capacity to execute any document or instrument or enter into any transaction. Each of these proposed actions must be determined based on the particular facts, circumstances, time frame, and abilities of the person subject to a guardianship. For example, under the current guardianship laws, persons under temporary guardianship are presumed to have capacity. *See* TEX. ESTATES CODE ANN. § 1251.002 (Vernon 2014). Furthermore, a ward subject to a permanent guardianship is presumed to retain all rights not expressly granted to his or her guardian. *See* TEX. ESTATES CODE ANN. § 1151.001 (Vernon 2014).

III. OVERVIEW OF STATUTORY AUTHORITY ADDRESSING INCAPACITY AND EXPLOITATION

There are a number of other statutes estate and guardianship attorneys should be familiar with as they can be both a tool and a weapon in cases involving alleged exploitation. A brief discussion of the more significant ones follows.

A. The Texas Estates Code.

The Texas Estates Code provides the most significant guidance in matters relating to the draft of the life time estate planning documents and options when they fail. They include the Durable Power of Attorney Act. *See* discussion *infra.* And when such options failure, Title 3 entitled Guardianships and Related Procedures, provides various options. TEX. ESTATES CODE ANN. Title 3 (Vernon 2014).

B. Texas Health & Safety Code.

Chapter 166 of the Texas Health & Safety Code governs the issuance of advanced directives. These include medical powers of attorneys and directives to physicians or "living will". *See* TEX. HEALTH & SAFETY CODE ANN. § 166.001, *et seq* (Vernon 2010).

While a medical power of attorney allows a person to designate one or more individuals to make his or her medical decisions in the event they are unable to do so, it has its limitations. For example, by statute, it is only effective during the times the client is unable to make his or her own health care decisions." *See* TEX. HEALTH & SAFETY CODE ANN. § 166.152(a) (Vernon 2010). Thus, if the principal does not believe he is incapacitated, then an agent's actions are often frustrated or blocked. *See* TEX. HEALTH & SAFETY CODE ANN. § 166.152(c) (Vernon 2010).

Likewise, an advanced directive allows an adult person to leave instructions regarding the termination or non-application of life-sustaining measures in the event he or she suffers from a terminal or irreversible condition. TEX. HEALTH & SAFETY CODE ANN. § 166.032 (Vernon 2010). If a person has executed an advanced directive, medical providers are required to follow the advanced directive unless is it is determined to be invalid.

And, the principal may revoke either a medical power of attorney or the directive "without regard to [his or her] mental state or competency." TEX. HEALTH & SAFETY CODE ANN. §§ 166.042, 166.155 (Vernon 2010).

C. Texas Human Resources Code.

1. Elder Bill of Rights.

Section 102.003 of the Texas Human Resources Code was enacted in 1997 to provide a "bill of rights" for elderly citizens. An elderly person is defined to be a person age 60 or older. *See* TEX. HUM RES. CODE ANN. § 102.001(5) (Vernon 2013). Generally, Section 102.003 provides that an "elderly individual has all the rights, benefits, responsibilities, and privileges granted by the constitution and laws of this state and the United States, except where lawfully restricted." The elderly individual has the right to be free of interference, coercion, discrimination, and reprisal in exercising these civil rights. *See* TEX. HUM RES. CODE ANN. § 102.003 (Vernon 2013). An elderly person expressly confirmed rights are defined to include:

- the right to make his or her own choices regarding his or her personal affairs, care, benefits, and services;
- the right to be free from abuse, neglect, and exploitation;
- the right to designate a guardian or representative to ensure the appropriate care is provided if a guardian is required.

See TEX. HUM. RES. CODE ANN. § 102.003(b) (Vernon 2013).

While some of an elderly person's rights can be modified or limited due to the appointment of a guardian, others do not appear to be. For example, Section 102.003(c) provides that an "elderly individual has the right to be free from physical and mental abuse, including corporal punishment or physical or chemical restraints that are administered for the purpose of discipline or

convenience and not required to treat the individual's medical symptoms." *See* TEX. HUM. RES. CODE ANN. § 102.003(c) (Vernon 2013). Furthermore, a care provider may only use physical or chemical restraints if the use is (i) authorized in writing by a physician, or (ii) necessary in an emergency to protect the elderly individual or others from injury. *See Id.* Before authorizing such restraints, a guardian or other person is required to obtain written authorization from a physician specifying the circumstances and length of time the restraints may be used. *See Id.* Unless it is an emergency, only qualified medical personnel may administer the restraints. *See Id.* Additionally, a mentally retarded elderly individual with a guardian of the person may participate in a behavior modification program that includes the use of restraints or adverse stimuli only with the informed consent of his or her guardian. *See* TEX. HUM. RES. CODE ANN. § 102.003(d) (Vernon 2013).

2. Duty of Nursing Homes to Respect Resident's Rights.

A guardian should confirm that if his or her ward must reside in a nursing home, that it respects the tenets of Texas' Elder Bill of Rights to the extent allowable due to the ward's conditions and retained rights. At a minimum, the nursing home should take such actions to confirm that:

- The ward is at all times appropriately dressed, well-groomed and clean.
- To the extent possible, the ward is allowed to express preferences about food, sleeping and waking times;
- Any treatments or personal care should be given in private, not in front of an open door;
- Its staff will treat the ward with respect and dignity.
- It will not engage in conduct that includes involuntary seclusion, intimidation, humiliation, harassment, threats of punishment, deprivation, hitting, slapping, pinching, kicking, any type of corporal punishment, any sexual contact without informed consent, sexual harassment, verbal abuse, or any oral, written, or gestured language that includes disparaging or derogatory terms, regardless of the person's ability to hear or comprehend.

See Attorney General of Texas Website www.oag.state.tx.us/elder (rights of elderly).

3. Limitations on Transfers and Discharges.

Furthermore, Section 102.003(r) restricts the right of a services provider to transfer or discharge an elder person unless:

a. the transfer is for the elderly individual's welfare, and the individual's needs cannot be met by the person providing services;
b. the elderly individual's health is improved sufficiently so that services are no longer needed;
c. the elderly individual's health and safety or the health and safety of another individual would be endangered if the transfer or discharge was not made;
d. the person providing services ceases to operate or to participate in the program that reimburses the person providing services for the elderly individual's treatment or care; or
e. the elderly individual fails, after reasonable and appropriate notices, to pay for services.

See TEX. HUM. RES. CODE ANN. § 102.003(r) (Vernon 2013).

In the event a transfer or discharge is authorized, the elderly person cannot be transferred or moved from a residential facility until the 30th day after the date the person providing services gives written notice to the guardian (or required person) unless it is due to an emergency. *See* TEX. HUM. RES. CODE ANN. § 102.003 (Vernon 2013). The written notice must state:

The service provider intends to transfer or to discharge the elderly individual;

- The reason for the transfer or discharge;
- The effective date of the transfer or discharge;
- The location to which the individual will

be transferred; and

- The individual's right to appeal the action and the person to whom the appeal should be directed.

See Id.

4. Duty to Report Abuse, Neglect or Exploitation.

To the extent that a guardian or other becomes aware of any specific acts of abuse, neglect, or exploitation, he or she is required to report it to the Texas Department of Human Services and Department of Protective and Regulatory Services. *See* TEX. HUM. RES. CODE ANN. § 48.051 (Vernon 2013). Section 48.051(c) provides that the duty imposed to report the abuse, neglect, or exploitation, include a person "whose knowledge concerning possible abuse, neglect, or exploitation is obtained during the scope of the person's employment or whose professional communications are generally confidential, including an attorney, clergy member, medical practitioner, social worker, and mental health professional." *See Id.* Therefore, not only is a guardian required to report such abuse, neglect, or exploitation, but also an attorney ad litem, guardian ad litem, employee of the ward's 867 trust, etc.

The required report may be made orally or in writing but must include the following:

a. the name, age, and address of the elderly or disabled person;
b. the name and address of any person responsible for the elderly or disabled person's care;
c. the nature and extent of the elderly or disabled person's condition;
d. the basis of the reporter's knowledge; and
e. any other relevant information.

See TEX. HUM. RES. CODE ANN. § 48.051(d) (Vernon 2013).

A person may be subject to criminal charges if he or she fails to report the abuse, neglect, or exploitation as required by Section 48.051. *See* TEX. HUM. RES. CODE ANN. § 48.052(a) (Vernon 2013 & Supp. 2011). If discovered, he or she may be charged with a Class A misdemeanor. *See* TEX. HUM. RES. CODE ANN. § 48.052(b) (Vernon 2013).

Furthermore, if the victim was a resident of a nursing home, the guardian or other person is required to contact the Texas Department of Human Services at 1-800-458-9858.

D. Texas Penal Code.

1. Section 22.04: Injury to Elderly or Disabled Person.

Section 22.04 of the Texas Penal Code provides that it is a criminal offense for a person with a legal or statutory duty to act or has "assumed care, custody or control" and "intentionally, knowingly, recklessly, or with criminal negligence, by act or intentionally, knowingly, or recklessly by omission, causes to a child, elderly individual, or disabled individual: (1) serious bodily injury; (2) serious mental deficiency, impairment, or injury; or (3) bodily injury." TEX. PENAL CODE ANN. § 22.04(a) (Vernon 2011). Section § 22.04(c) defines child, elderly individual and disabled person as follows:

a. "Child" means a person 14 years of age or younger.
b. "Elderly individual" means a person 65 years of age or older.
c. "Disabled individual" means a person older than 14 years of age who by reason of age or physical or mental disease, defect, or injury is substantially unable to protect himself from harm or to provide food, shelter, or medical care for himself.

See TEX. PENAL CODE ANN. § 22.04(c) (Vernon 2011).

If the injury results in serious bodily injury or mental deficiency, impairment, or injury, the offender could be charged with a felony of the first degree if the conduct is committed intentionally or knowingly. TEX. PENAL CODE ANN. § 22.04(e) (Vernon 2011). If the conduct resulted from recklessness, the offender could be charged with a felony of the second degree. *See Id.* If the conduct resulted from criminal negligence, the offender could be charged

with a state jail felony. TEX. PENAL CODE ANN. § 22.04(g) (Vernon 2011).

When the injury results in bodily injury, the offender could be charged with a felony of the third degree if the conduct is committed intentionally or knowingly. TEX. PENAL CODE ANN. § 22.04(f) (Vernon 2011). If the conduct resulted from criminal negligence, the offender could be charged with a state jail felony. TEX. PENAL CODE ANN. § 22.04(g) (Vernon 2011).

2. Section 31.03: Theft.

Section 31.03 of the Texas Penal Code provides that it is a criminal offense when a person "unlawfully appropriates property with intent to deprive the owner of property." TEX. PENAL CODE ANN. § 31.03(a) (Vernon 2011). While Section 31.03 does not specifically apply to fiduciaries, anyone deemed to be acting in that capacity could also be charged with an offense under this section in addition to more specific offenses. *See Billings v. State* 725 S.W.2d 757 (Tex. App.—Houston [14th Dist.} 1987, no writ) (conviction under general theft statute would not be reversed even though prohibited conduct was covered by more special statute prohibiting fiduciary from misapplying fiduciary property, where both statutes were graded equally depending upon value of property misappropriated, and prosecution under either statute subjected offender to same range of punishment).

If charged with theft, the severity of the offense will range from a Class C misdemeanor for property less than $50, to a first-degree felony for property in excess of $200,000. *See* TEX. PENAL CODE ANN. § 31.03(e) (Vernon Supp. 2011). However, when the legal owner is an elderly person, the possible punishment is increased to the next higher category of offense. *See* TEX. PENAL CODE ANN. § 31.03(f) (Vernon 2011).

3. Section 32.45: Misapplication of Fiduciary Property.

Section 32.45 of the Texas Penal Code provides that it is a criminal offense for a person, with a legal or statutory duty to act, to "intentionally, knowingly, or recklessly misapply property he holds as a fiduciary or property of a financial institution in a manner that involves substantial risk of loss to the owner of the property or to a person for whose benefit the property is held." TEX. PENAL CODE ANN. § 32.45(b) (Vernon. 2011). Section 32.45(a)(1) defines a fiduciary to include a attorney in fact, agent, trustee, guardian or anyone else ating in a fiduciary capacity. TEX. PENAL CODE ANN. § 32.45(c) (Vernon 2011). The offender will be charged with an offense dependent on the value of the misappropriated property. They range from a Class C misdemeanor for property less than $20, to a first-degree felony for property in excess of $200,000. TEX. PENAL CODE ANN. § 32.45(c) (Vernon 2011).

4. Section 32.46: Securing Execution of Document by Deception

Section 32.46 of the Texas Penal Code addresses fraud based on the execution of documents by deception. Section 32.46(a) provides that a "person commits an offense if, with intent to defraud or harm any person, he, by deception, "causes another to sign or execute any document affecting property or service or the pecuniary interest of any person." TEX. PENAL CODE ANN. § 32.46(c) (Vernon 2011). The punishment depends on the value of the property involved. It is felony when the value is $1,500 and the degree depends of the actual value. See Id.

5. Section 32.53. Exploitation of Child, Elderly Individual, or Disabled Individual

Section 32.53 was added to the Texas Penal Code in the last legislative session. TEX. PENAL CODE ANN. § 32.53 (Vernon Supp. 2011). It specifically adopts the definitions of "child," "elderly individual,"

and "disabled individual" in Texas Penal Code Section 22.04. It also defines exploitation to mean "the illegal or improper use of a child, elderly individual, or disabled individual or of the resources of a child, elderly individual, or disabled individual for monetary or personal benefit, profit, or gain." *Id.* A person can be guilty of a third degree felony if they "intentionally, knowingly, or recklessly cause the exploitation of a child, elderly individual, or disabled individual." *See* Id.

IV. PLANNING FOR A POTENTIAL CHALLENGE.

When a client suffers from a condition that may raise an issue whether he or she lacks capacity to execute a will or similar estate planning documents, consider including additional provisions and/or taking extra precautions that may be beneficial in the event that the document is later challenged. A discussion of some commonly utilized suggestions follows.

A. Gather Evidence of Client's Capacity.

First, determine whether it would be beneficial to obtain additional evidence as to the client's capacity to engage in the contemplated transaction. In making this determination, an advisor should review the client's age, current and prior health, family relationships, possibility of conflicts and challenges, and complexity of the anticipated transaction. Evidence of a client's capacity is often beneficial when a client is advanced in age and foresees a challenge to his or her estate plan. Such evidence is particularly important when the client suffers from an existing disability that could call his or her capacity into question. Each of these points is discussed in below.

1. Non-Medical Evidence.

Most estate planning representations begin with a face-to-face meeting with the client or potential clients. It is during the initial meeting that an attorney, either knowingly or instinctively, begins the process of evaluating his or her client for purposes of gathering evidence of a client's requisite mental or testamentary capacity. Such assessment is vital to ensuring that the client's wishes are carried out. Often the estate-planning attorney is the single most important witness in a subsequent challenge to the client's capacity. It is his or her observations that are the foundation of the proponent's case when asserting the client had the requisite capacity to execute the will, trust, or other estate-planning document. Because capacity is a fundamental requirement to execute the will, the attorney can typically venture into areas that would otherwise be considered outside the scope of legal representation. Often the client understands it is necessary to ask these questions to increase the likelihood the will or estate planning document will be enforceable in the future.

The extent of this evidence-gathering process generally depends on the age, medical condition, and any possible disabilities of the client. Therefore, when the client is in their forties, has suffered from no accident or head injury, and appears to exhibit no signs of the questionable capacity, the initial assessment may be nothing more than asking about his or her family, property, and his or her proposed disposition. When a client is in the first stages of Alzheimer's, however, additional information should be requested as part of the initial assessment. For example, the attorney may ask about the client's family history including, but not limited to, children, grandchildren, brothers, and sisters, even though these individuals may not be included in the estate plan. It is the attorney's ability to testify that the client was aware of all these individuals that will further clarify or provide evidence that the testator knew of his family, even the extended family, at the time he or she executed his or her will. If the testator intends to leave his or her property to someone other than the "natural objects of his or her bounty," the attorney and client should discuss the client's reasons for this disposition. Regardless of the reasons, if the client's intent is founded on a reasonable basis, this will support the admission of the will and the client's capacity.

Additionally, the lawyer should discuss in detail the client's property interests. Again, this will allow the attorney to testify that the testator was familiar with the nature and extent of his or her property.

Finally, the attorney should discuss with the client his or her medical condition, the medications he or she is taking, and, if appropriate, ask the client to recall various matters of local or national significance. Often a client will not be insulted when asked these questions after a candid conversation with regard to your desires to make yourself a fact witness so his or her intent can be carried out at a later date.

2. Medical Evaluations.

In certain cases, it may be appropriate for the client to seek a medical evaluation before proceeding with the estate planning representation. This evaluation serves two (2) purposes. First, it may be questionable whether the client has the requisite capacity to execute his or her estate planning documents. This sometimes occurs after a client has had a stroke, brain injury, or is subject to a guardianship. In these situations, the medical evaluation may be beneficial in determining the client's capacity to proceed with the requested representation. Second, while the attorney may be comfortable the client possesses the requisite capacity to pursue the representation, the client's family or financial situation may indicate that a subsequent will contest is likely. In such cases, a medical evaluation on or around the time of the execution of estate planning documents often provide additional evidence that the testator had the requisite capacity to engage counsel and execute his or her estate planning documents.

a. Documentation.

The medical evaluation may simply be recorded in the physician's medical records. For example, on the day the document is signed, the client may schedule his annual physical. The client would ask his physician to note that he is good health, oriented, alert, etc.

Alternatively, the results of an examination may be preserved in the form of a letter from the client's treating physician or a complete psychological or neurological evaluation. A letter may range from a simple confirmation of an examination to a lengthy letter that advises the attorney of the results of a full mental health evaluation.

b. Selecting the Physician.

Generally, a client's long-term treating physician should be first considered to provide or document a client's capacity. However, not all physicians will be automatically recognized as competent to provide an opinion of a person's capacity. *See Broders v. Heise*, 924 S.W.2d 148 (Tex. 1996) (Texas Supreme Court affirmed exclusion of emergency room doctor's testimony offered to establish relationship between patient's head injury and death). For example, in *Broders,* the Texas Supreme Court found medical experts are not automatically qualified to testify as to all matters simply because they possess a medical degree. *Id*. at 153 (*citing Ponder v. Texarkana Memorial Hosp*., 840 S.W.2d 476, 477-78 (Tex.App. – Houston [14th Dist.] 1991, writ denied)). Texas courts will generally recognize internists, psychiatrist, neurologist and those with a geriatric specialty as experts on capacity issues. Opinions by other medical specialists, i.e., an orthopedist, gynecologist or podiatrist, may not be automatically recognized.

If a physician is to be retained for purposes of completing the medical evaluation, a psychiatrist or neurologist is preferable. A good approach to selecting a physician is to ascertain and hire a physician that the court routinely appoints to conduct an independent psychiatric examination in guardianship proceedings. These individuals generally have the court's respect and the requisite level of expertise in the areas of capacity and mental examinations.

Regardless of the physician selected, he or she should be board certified, if possible, and have adequate credentials. At the time of the testing, the physician should be aware of

the applicable capacity test, including testamentary, and any other capacity which may be required, in order to execute the proposed documents. When the client is subject to a guardianship, permission of the ward's guardian, and possibly the court, may be required to proceed. This can be generally handled by the guardian submitting an application to the court advising it of the ward's requests and seeking permission to proceed with psychological and neurological testing of the ward in order to determine whether he or she has the requisite capacity to execute estate planning documents.

B. Drafting Considerations.

1. Simplicity Versus Complexity.

Inherent in the definition of capacity is the requirement that the person understood the transaction in which he or she was engaged. For example, testamentary capacity requires that the testator understood he or she was executing a will, and the effect of its terms. Due to our current transfer tax structure, most wills include lengthy and complex provisions that address a plethora of administrative and tax issues. While generally advisable, these additional provisions can create a lengthy and onerous document.

When a challenge based on capacity may be an issue, the advisor should opt for simplicity over complexity. A contestant of the will may attempt to convince a jury that the testator could not have understood the contents of the will and thus could not have had the requisite testamentary capacity. Putting the proponent on the stand and asking him or her to explain certain portions of the will can illustrate this. While the test for testamentary capacity does not require that the testator understand every provisions of his or her will, a jury may be persuaded by this argument.

When drafting a will or similar dispositive instruments, the drafter should attempt to simplify the document based on the facts and circumstances of the particular client. For example, a client that has a marginally taxable estate may benefit from a shorter will that provides for the outright disposition of his or her estate and only includes necessary boilerplate to ensure the bequests are carried out. The drafter may choose to exclude standard provisions providing for contingent trusts, addressing administrative issues, and providing for the payment of transfer taxes, including tax apportionment, etc.

2. Identify Family Members – Included and Excluded.

One of the elements of testamentary capacity is that the testator is aware of the natural objects of his or her bounty. *See* discussion *supra*. It is advisable to identify the testator's family in the will even if he or she does not intend to provide for them. This evidences that the testator was aware of these individuals. The will may also include a statement that the testator has made no provision for them in his or her will, however, any stated reasons should be carefully drafted to avoid a potential claim of testamentary slander. If the documents identify the beneficiaries by name, it is important to make sure the testator has their names spelled correctly.

3. Identify Assets - Generally.

Another element of testamentary capacity is that the testator is aware of the nature and extent of his property. *See* discussion *supra*. As evidence, the drafter should consider identifying the testator's assets. A detailed listing is not necessary. Rather, the will may include a general listing of the assets in the will. For example, they may provide that the testator owns a home in Austin, a vacation house in Kerrville, cash, securities, automobiles, furnishings and personal effects and other real and personal property. Again, this provides some evidence in a subsequent will contest of the testator's capacity.

C. Accommodations for Visually Challenged Clients.

When the testator suffers from impaired vision, consideration should be given to how

the testator will review the document prior to its execution. The computer age provides a number of tools to assist in this regard. If the testator has limited sight, the drafter should consider enlarging the print size. Similarly, double-spacing the document and/or a magnifying glass often assists the testator when reviewing the proposed will. If, however, the testator has such limited sight that he or she cannot review the document, the drafter, in the presence of witnesses, should read the will to the testator. Pour-over wills are often recommended in these situations. This allows the drafter to read the entire will and the dispositive provisions of the trust to the testator in a reasonable period of time.

D. The Execution "Ceremony".

1. Location, Location, Location.

When there is an increased likelihood of a contest, the drafter should give careful consideration to where the document is executed as this is often a focus in a subsequent will contest or similar proceeding. If possible, the client should execute his or her estate planning documents at the drafting attorney's office. This is indicative of a typical business arrangement and that the client's health was sufficient to travel to the attorney's office. If at all possible, the client and the drafting attorney should exclude all beneficiaries and designated agents from the execution arrangements. While the client may depend on these persons, it is that dependency that can lead to claims of influence or manipulation. The client should be encouraged to drive him or herself, if able, or arrange another means of travel that indicates a level of capacity.

If it is necessary to execute documents at home or in a hospital, arrangements should be made to ensure independent and credible witnesses and a Notary Public are present. It is also helpful if the witnesses and Notary Public are persons who can be readily located in the future.

2. Persons Present at Execution.

As discussed *supra*, all potential beneficiaries and agents should be excluded from the execution ceremony. The advisors should also encourage the client to exclude potential beneficiaries and agents from all arrangements related to the drafting of the documents, including driving the client to meetings, reviewing drafts of the will and other documents, reading the documents to the client, being present at any meeting between the client and his attorney, and paying (directly or indirectly) for the estate plan. Further, at least two (2) credible and competent witnesses and a Notary Public should be present during the *entire* ceremony. *See* discussion *infra*.

3. Selecting Witnesses and Notary Public.

It is important to select witnesses that will be good witnesses in the future. The Notary Public is a witness as to the formalities and his or her observations. Potential witnesses may include, attorneys, legal assistants, the client's accountant or other professional advisor, long-term friends of the client, or a spiritual advisor. Consideration should be given to witnesses that will be available and willing to testify in the future. At the execution ceremony, it is advisable to encourage these individuals to engage in conversation with the client and, if appropriate, ask questions to satisfy any capacity questions or concerns. The extent of the conversation and interaction depends on their prior contracts with the client.

If capacity is a significant issue, the attorney should also consider involving a medical professional in the execution ceremony, either as an attesting witness or consultant prior to the execution. It is advisable to weigh the impact his or her presence may have in triggering an inquiry by an interested party or the court which might not otherwise occur. This requires a balancing act. If undecided, err on the side of caution and involve the medical professional.

When the client is hospitalized, the attorney should consider whether to discuss with the client's physician or the nurse on duty the client's present condition prior to

executing the estate planning documents. It may also be beneficial to find out whether the client had visitors and, if necessary, interview them. In certain circumstances, it may be advisable to review the client's medical chart and encourage a notation as to the client's mental state at or near the time of the document execution.

The drafter should also consider whether it would be beneficial to review each provision of the will and other documents with the client in the presence of the witnesses. When reviewing a will or trust, explain the effect of a particular provision on the bequests made to other family members. Also, secure a confirmation of a large gift to one child. If the client confirms that he or she understands the effects of his or her plan, the drafter will have more assurance that the client fully understands the entire estate plan. As an extra precaution, it may be useful to read the instrument in the presence of the attesting witnesses. If possible, the will should be simple and easy to understand. Simplicity ensures that the client understands each provision and will not tire before the will is read and executed.

Finally, the execution ceremony should be conducted with a high level of formality. The witnesses and Notary Public should remain in the client's presence during the entire execution ceremony. They should all be in each other's presence when signing the documents. After the documents are signed, the Notary Public should administer all required oaths and require each witness to raise their hand while doing so. It is these details that will be the subject scrutiny if the documents are challenged.

E. Memos to File.

Upon the conclusion of the execution ceremony, the attorney should consider dictating a memo to his or her file. The memo may later refresh the recollections of the attorney in the event of a challenge to the documents. The memo should reflect the persons in attendance, the place of execution, any significant matters discussed, for example, the identity of family members, the reasons for executing the documents, and that the client understood the documents he or she was executing. Furthermore, the memo should reflect when persons entered and left the place of execution, and the time and sequence of the execution ceremony, for example, which documents were signed first, who took the requisite oaths, etc. If possible, the witnesses and the Notary Public should prepare similar memos for the attorney.

F. Storage of Documents.

An attorney should discuss with the client where the documents should be stored. Some clients may be better served when the attorney keeps the original documents. Other clients want to take possession of the original documents. This can, however, lead to future claims of loss, revocation, and destruction by third parties. Regardless of the ultimate decision made, the attorney should document the storage of the documents in their file. If the instruments are given to the client, the attorney should follow up with a letter to the client confirming that the client decided to take possession of these documents. The attorney may also suggest that the documents be placed in a safe deposit box to avoid access by third parties. Alternatively, if the client requests that the attorney continue to maintain the originals in his or her offices, this should be confirmed in a letter.

Also, if the client does not want the attorney to release the will to third parties, in the event of future incapacity, this fact should be confirmed in a letter to the client. Such a request becomes significant in the event a guardian of the client's person and/or estate is appointed. *See* discussion *infra.*

G. File Maintenance.

Efforts should be taken to maintain the client's file. The attorney's file is generally the first document subpoenaed in a lawsuit involving the validity of the estate plan. This will occur after the client's death in a will contest; however, it may occur sooner when a guardianship proceeding is commenced involving the client's person or estate. Therefore, at the conclusion of the

engagement, a review should be made of the file to confirm it is in good order in the event it must be produced. A review may include confirming that the attorney's notes are in good order (if retained), deciding whether any phone message reminders should be retained, and deciding whether any drafts with the client's (or another's) handwriting should be retained. Copies of the signed documents should be included in the file. Affidavits of any witnesses and Notary Publics, and memos to the file should be placed in the client's file. It is also beneficial to include a copy of the page in the Notary Public's record book relating to the documents. It is important to recognize that once a file is subpoenaed or subject to a document production request, it must be produced in its then existing form.

V. WAYS TO REDUCE POTENTIAL FOR LITIGATION AT PLANNING STAGE.

The best defense to a potential interloper is a good offense. *See Donaho*, Offensive and Defensive Estate Planning, State Bar of Texas 25th Annual Estate Planning and Probate Course, June 2001. And, that defense begins in the estate planning stage. A client and his or her advisors should consider what estate planning technique is best suited to both meet the client's estate planning and objective, and also reduce potential conflicts and claims. There is never one perfect option. Rather, considerations may include:

- Client's age and lifestyle;
- Marital status: first or multiple marriages;
- Intended beneficiaries;
- Family conflicts;
- Separation of conflicting interests;
- Charitable intentions;
- Type of assets involved: Cash, Securities, Real Estate, Business;
- Location of assets;
- Management objectives: lifetime and at death;
- Investment objectives;
- Level of management need: lifetime and at death;
- Creditor issues;
- Client's level of involvement in assets;
- Matching client's ability/desire for complexity versus simplicity;
- Potential for interlopers: lifetime and at death;
- Need for tax planning;
- Persons available to act as a fiduciary; and
- Current financial markets.

Wills, management trusts, partnerships, and similar entities continue to be the most common and advantageous means to manage a client's assets. While a discussion of all aspects of these vehicles and provisions are beyond the scope of this outline, a discussion of various basic options and considerations follows.

A. Ancillary Documents

Financial and medical powers of attorney are commonly used to plan for a client's incapacity. But, an estate planner must do more than simply appoint a fiduciary in the suggested statutory forms. Careful planning can often reduce the likelihood of litigation and/or interference by a third party.

1. Document Should Specifically Grant Agent Desired Authority

Financial powers of attorney provide general broad grants of authority to the designated agents. Powers that are not expressly stated in the document will not, however, be generally deemed to be conferred upon the designated agent. Therefore, the power of attorney should be drafted in a manner that grants the agent the authority to handle the transactions, transfers, gifts, or other powers contemplated by the client. Failure to provide specific authority to exercise certain rights of the principal, such as the right to make gifts, establish a revocable trust, modify a trust agreement, remove trustees, require accountability from other fiduciaries, exercise powers of appointment, or make charitable gifts, can result in the inability of the client's representatives to

handle such matters in the event of his or her incapacity, and lead to litigation.

2. Appoint Successor Agents

It is advisable for a client to appoint both original and successor agents to make financial decisions. Third parties may attempt to either intimidate an agent into non-action or resignation, or the agent may not be able to serve due to incapacity or death. A client will have greater assurance that his or her desires will be carried out by the appointed agents rather than a guardian when he or she designates a number of persons who can act if the predecessor agent cannot serve or qualify.

Furthermore, if the client intends to appoint non-family members as his or her agent, the advisor should understand the reasons for the appointments in the event this becomes an issue in the future. This will allow the client's advisors to assist the client in carrying out his or her desires, defend an agent when appropriate, and potentially avoiding a guardianship should one be sought by the client's family members.

3. Appoint Agents Who Do Not Have Potential Conflicts Of Interest (When Possible)

A client should consider appointing at least one agent or successor agent that would not have a potential conflict between his duties as the client's agent and his individual or other interests. For example, a person who also serves as both attorney-in-fact and trustee for the client could face subsequent claims of conflict arising from his duty to account while the client is incapacitated. A court considering an application for guardianship may determine a guardian of the client's estate is necessary to provide independent review and oversight because of the potential conflict. A client should also consider appointing at least one person who, if possible, has no duty to account to the client in any other capacity. Special agents may be another option.

4. Expressly Address Creation And/Or Funding Of Management Trust

Management trusts are an effective technique to provide for future management of a client's assets in a manner selected by the client prior to his or her incapacity. These trusts reduce the risk that individuals will attempt to gain control of the client's estate through a guardianship, allows the client to direct the future management of his or her assets when he or she is unable to do so, and reflect a reasoned and appropriate business judgment. Typically, the courts presiding over guardianship proceeding will respect the creation of a management trust, either by the client or by an agent pursuant to a duly executed durable power of attorney, if the terms of the trust are standard in nature and do not allow overreaching by the trustee or third parties. Furthermore, even if the client has questionable capacity, the courts will generally not seek to set aside the management trust when a corporate trustee is managing the assets and the beneficiary is the alleged incapacitated client.

To allow for the creation and/or funding of a management trust by an agent under a power of attorney, the agent's authority to create, modify, or terminate the trust should be clearly set out in the durable power of attorney. An attorney-in-fact under a durable power of attorney is generally deemed to have only those powers delineated in the instrument. *See* Restatement (second) of Agency § 34, cmt. H (1999). And, at least one Texas appellate court has held that a statutory form power of attorney does not allow an agent to create a trust. *See Filipp v. Tite*, 230 S.W.3d 197(Tex. App. – Houston [14th Dist.] 2006, no pet.). Therefore, if the client seeks to allow his or her attorney-in-fact to have broad authority with regard to a trust, consideration should be given to include the following powers:

- Power to establish management trust for the principal;
- Power to invest in limited partnerships, etc.;

- Power to appoint both initial trustee, individual or corporate, and successor trustee;
- Power to remove a trustee and standard for removal;
- Power to demand accounting and inspect trust books and records;
- Power to demand distribution on principal's behalf;
- Power to authorize tax-motivated gifts by the trustee and the release of the trustee for not exercising such powers;
- Power to fund some or all of a principal's assets into the trust;
- Power to modify terms of the trust; and
- Power to exercise powers of appointment.

An agent cannot, under any circumstance, execute a will for the principal. Additionally, to avoid claims against the agent for alleged conflicts of interest but to also provide for some level of accountability, the durable power of attorney may provide that the trust must be established with a corporate fiduciary rather than an individual. In the event a family member questions the agent's actions, the agent would then have the ability to establish a management trust to prevent the client's assets from being subjected to an unnecessary and retaliatory guardianship.

5. Consider Gift and Tax-Planning Powers

As previously discussed, because a durable power of attorney survives the incapacity of the principal, it can be relied upon for management of the principal's affairs and, potentially, for ongoing gift and estate planning. While durable powers of attorneys often grant broad authority to the attorney-in-fact, powers not expressly conferred will not usually be implied under the law of agency. For example, if the power to gift is not expressly conferred by the durable power of attorney, the authority will generally not be implied. In fact, the Internal Revenue Service has previously challenged the authority of an agent to make gifts when the express power to gift is not included in the durable power of attorney. *See generally* AGENTS UNDER POWERS: CAN THEY MAKE GIFTS? 19 TAX MGMT. EST., GIFTS & TR. J. 89 (1994). The general assumption is that the agent must act in the principal's best interest and by giving away the principal's assets, the agent is not acting in the principal's best interests. Texas, like most states, appears to follow the common law rule that a durable power of attorney without a specific grant of gifting authority does not include a power to gift.

When an attorney-in-fact makes gifts on behalf of a principal under a durable power of attorney that does not contain a specific power to make gifts, the IRS will likely assert that the gifts are includible in the gross estate of the deceased principal because the transfer was revocable. The basis for this assertion is that, if the principal regained the capacity to act, the principal could have recovered the unauthorized gifts even if the principal did not, in reality, have the mental capacity to revoke the gift; and a transfer that is revocable by a decedent is includible in the decedent's estate for estate tax purposes. IRC § 2038. While a few courts have interpreted broad grants of power to include the power to make gifts, most courts have agreed with the IRS' assertion. *See, e.g., Swanson*, 46 Fed. Cl. 388 (2000) (since no express gifting authority given to agent, decedent retained right to revoke each of thirty-eight $10,000 gifts and each gift properly included in decedent's gross estate for estate tax purposes); *Estate of Casey v. Comm'r*, 948 F.2d 895 (4th Cir. 1991); *Estate of Bronston v. Comm'r*, 56 T.C.M. (CCH) 550 (1988); *Estate of Gagliardi v. Comm'r,* 89 T.C.M. 1207 (1987); *Estate of Council v. Comm'r*, 65 T.C. 594 (1975).

But, the agent gifting authority should not be unlimited, because (i) they will be considered to possess a general power of appointment, and (ii) if the agent predeceases the principal, the principal's entire estate could be included in the agent's gross estate.

If gifting authority is desired, the durable power of attorney should include a specific statement granting the agent gifting authority.

In drafting gifting provisions, consideration should be given to degree of authority given to the agent and the potential for creation of a general power of appointment under I.R.C. Section 2041 if such authority is overly broad. Potential gift powers may include:

- Gifts limited to the gift tax annual exclusion;
- Gifts of an amount not to exceed the principal's unused applicable exclusion or credit amount. I.R.C. § 2010(c);
- Gifts to a specific class of potential beneficiaries;
- Gifts using the ascertainable standard (e.g., health, education, maintenance, and support) exception to the general power of appointment rule;
- Gift of only the greater of $5000 or five percent ("5 and 5 power") of the aggregate value of the assets subject to the power; and
- Gifts to specific charities or types of charitable gifts.

6. Include Ways To Reduce Potential For Abuse

It is important to remember that while the annual exclusion and alternate limitations discussed above are designed to provide ongoing estate and gift planning flexibility without unintended gift or estate tax consequences, provisions may need to be included with an eye toward a reduction in the potential for abuse.

a. Prohibiting Gifts To Agents

The ability of an agent to make gifts to himself or herself can lead to a number of issues. To avoid abuse or allegations of abuse, a client should consider excluding his or her agent as a possible donee.

b. Appointing Special Agents

The appointment of special agents can be used for a variety of reasons. A special agent can be used to serve as a double check on the agent, provide a means to reduce claims of self-dealing or conflict by the primary agent, to allow gifts to be made to the primary agent, or to create a system of accountability during periods of the principal's incapacity.

c. Addressing Agent Compensation

The agent's ability to receive compensation for acting as agent can lead to financial abuse or at a minimum an allegation of abuse that results in litigation. Thus, it is advisable to clarify the agent's right to compensation by including a specific compensation provision. Examples that may be used exclusively or "mixed and matched" include:

- My Agent shall not be entitled to compensation for services rendered under this instrument.
- My Agent shall be paid annual compensation at the maximum rate for fiduciaries permitted by statute.
- My Agent shall be paid on a monthly basis for services rendered as my agent at the rate of $____ per hour of service. Compensation shall be calculated pursuant to written records created and maintained by my Agent and shall be limited to such hourly charges.
- My Agent shall be paid annual compensation in an amount equal to ____% of the income from all assets over which my Agent has assumed management responsibility and/or investment responsibility.
- When any two or more Agents are serving jointly, compensation paid under the term of this instrument shall be divided among or between them in such manner as they shall agree or, if they fail to agree, as determined by binding arbitration. In reaching a decision, I direct the arbitrator to consider the responsibilities assumed by each Co-Agent, the results achieved, and the respective effort expended by each Co-Agent.

d. Including Express Limits On Agent's Authority

While broad powers increase the ability of an agent to act on the principal's behalf, they can also lead to unintended actions or

even abuse. For example, the sale of a specific bequest can lead to abatement of the gift and thus a shift in the value of the intended bequests in a client's will. Also, the closing of a right of survivorship account may interrupt an anticipated transfer.

Consideration should be given to whether to limit an agent's powers. The power of attorney should expressly state any limitations on an agent's powers. Potential limitations include prohibiting an agent from:

- Amending a trust;
- Changing beneficiary designations;
- Closing or withdrawing assets from certain right of survivorship accounts;
- Transferring or terminating life insurance policies;
- Withdrawing the cash value of certain life insurance policies;
- Selling or transferring certain assets or limiting such transfers to certain persons; or
- Making gifts to certain persons or a class of persons, *see* discussion *supra*.

7. Designate Guardian In The Event Need Arises

Chapter 1104 of the Texas Estates Code authorizes a client to designate a guardian of his or her person and/or estate if the need arises. With careful planning, the need for a guardianship can often be reduced, if not completely avoided. Unfortunately, notwithstanding the best planning, a family member, child, distant relative, or even an unrelated individual may seek a guardianship in order to undermine the intentions of the client and the authority of his agents during the period of his incapacity. Thus, the client should execute a designation of guardian in the event need arises, naming one or more individuals who the client trusts to serve as his guardian. By appointing such trusted individuals, a potential applicant for guardian may have a disincentive when attempting to use a guardianship proceeding to interfere and intervene in the client's affairs.

And, a client may designate individuals the client does not wish to serve as guardian. Courts must consider the disqualification of a person when making its decision as to who should be appointed as the client's guardian, in the event it is necessary. TEX. ESTATES CODE §§ 1104.202, 1104.351-357. Therefore, the designation of guardianship should name each and every person, entity, or classes of persons that the client does not wish to serve as his or her guardian in the event the need arises.

Unfortunately, the disqualification of an individual to serve as a client's guardian may not be enough to avoid attempts to interfere in the client's affairs. Such individual may pursue the appointment of a guardian for the purposes of undermining a client's estate plan. Furthermore, the courts may not be able to appoint a designated guardian if he or she has a duty to account to the client. On many occasions, the individual may be able to account for their actions prior to their qualification as guardian. But, when the financial matters are complicated, or the agent is not in a position to properly account for his or her actions, the court may deem him or her disqualified to serve as the client's guardian. *See* TEX. ESTATES CODE ANN. § 1104.354 (Vernon 2014). In this situation, a person other than the individual selected by the client could be appointed to control the client's assets. Therefore, some thought should be given to the individuals designated to serve in the event need arise. If possible, a client should appoint one or more individuals that do not have an interest or involvement in the client's financial affairs that could be construed or deemed to be a basis for disqualification or adverse interest.

Furthermore, if one (1) or more of the named guardians are indebted to the client, considerations should be given to planning for such indebtedness to avoid a disqualification arising from the debt. Section 1104.354 of the Texas Estates Code provides that a person who is indebted to a proposed ward is disqualified to serve as guardian unless the person pays the debt before appointment. *See* TEX. ESTATES CODE § 1104.351. If a client seeks to appoint a person who may be indebted to him, as his designated guardian,

the client should consider either forgiving the debt or re-characterizing it as an advancement of any bequest under the client's will to avoid potential disqualification.

B. Selecting Management And Dispositive Instrument

The selection of the appropriate management and dispositive instrument can be an invaluable asset in reducing potential claims and resulting litigation. A discussion of the more common estate planning options follows.

1. Wills

The execution of a well-drafted will remains fundamental to every client's estate plan. A will can be as simple as a pour over will, or serve as a stand-alone document that provides for multi-generational planning and control. Benefits of using a will as the governing document include:

- Clients are generally familiar with need for wills;
- Cost of drafting generally moderate;
- Level of capacity clearly testamentary;
- Effective only at death - creates no claims or rights until death;
- Allows for full use and control of property until death;
- Can be drafted to provide significant control of property after death; and
- Can include provisions that deter attacks – no contest clauses, indemnities, etc.

Unfortunately, the use of a will also presents some distinct disadvantages. These include:

- Not effective until probated;
- Cannot be amended or modified after client's incapacity;
- A will contest can be used as leverage by interlopers;
- Third parties may attempt to intimidate named executor with threats of litigation;
- Any interested party may file a contest to the selected executor's appointment to delay or avoid his or her appointment;
- Beneficiaries may have no funds with which to retain counsel to defend the will;
- The beneficiaries can agree not to probate the will and enter into a family settlement agreement to avoid its terms;
- Third parties may attempt to induce client to revoke a will prior to death;
- Probate assets subject to creditor claims;
- Lack of privacy due to filing of terms of will and required inventory; and
- Requires ancillary probate when real property located in other states.

2. Management Trusts

A management trust continues to be one of the most effective means to provide for the uninterrupted management of financial assets. Advantages of a management trust include:

- Effective on creation;
- Continued management in the event of a client's incapacity;
- Ability to select terms and appoint trustees;
- Provides a least restrictive alternative to a guardianship;
- Can include provisions that deter attacks – no contest clauses, indemnities, arbitration, etc.;
- Provides more privacy than a will;
- May avoid a probate proceeding;
- Simplifies transfers of assets in other jurisdiction;
- Trustee is generally able to defend the trust with trust assets; and
- Can be drafted to allow for modification or amendment after a client's incapacity.

While a management trust is often beneficial, it has its disadvantages also. Potential disadvantages include:

- Expenses in creating and funding;
- Provides no protection from creditors;
- Client's assets must be transferred to the trust to maximize benefit;
- Adds an additional level of complexity to an elderly client;
- Potential investment limitations;

- Client may not recognize that he no longer has the capacity to serve as trustee;
- Third parties may attempt to induce client to revoke trust when incapacitated;
- Third parties may attempt to intimidate third party trustee with threats of litigation; and
- Third parties may claim level of required capacity is higher than necessary to execute will.

To optimize the effectiveness of a management trust, the trust should be funded with a nominal amount of cash or fully funded with all the client's real and personal property. Furthermore, the grantor should also execute a durable power of attorney that addresses the agent's powers with regard to the trust. The power of attorney may limit the agent's power to transfer assets into the trust or grant the agent broad powers that include, but are not limited to, the power to create or fund the principal's management trust.

One of the most significant advantages of a stand-by management trust is that the trust is established by the principal rather than an agent. Thus, it allows the client to include safeguards and provisions such as authorized self-dealing, indemnities, broad investment authority, and broad exonerations and releases that may be seen as self-dealing if created by an agent under a durable power of attorney. Furthermore, unlike powers of attorney, a trust will generally be unaffected by the subsequent appointment of a guardian of the grantor's person or estate.

a. Fully Funded Revocable Management Trusts

A fully funded management trust can be an effective defense against some types of litigation. Unlike a will, a trust does not require adjudication prior to its enforcement. The trust is presumed to be valid until a person with standing is successful in establishing the client lacked capacity to create the trust. Therefore upon the client's death, the trust increases the likelihood of continued uninterrupted administration and disposition of all assets funded into the trust prior to the client's death.

The trust can also provide for the payment of a named executor's legal fees to pursue the probate of the client's will. This prevents the named executor being placed in a financial stranglehold pending the admission of the will to probate and the payment of his fees and expenses incurred in admitting the client's will to probate. It is advisable include a provision in the trust agreement to expressly allow trust distributions for such proposes.

Of course, the key is to have transferred the majority, if not all, of the client's assets to the trust prior to the client's death to avoid the need to engage in a protracted will contest. Therefore, the client should attempt to execute the necessary deeds and conveyances while he or she has capacity. The client's attorney-in-fact should also be expressly authorized to transfer the client's assets to the trust. *See* discussion *supra.*

b. Irrevocable Management Trusts

Like a fully funded management trust, an irrevocable management trust is an effective defense against some types of litigation. The trust is effective upon creation and does not require adjudication prior to its enforcement. The trust is presumed to be valid until a person with standing is successful in establishing the client lacked capacity to create the trust.

Furthermore, an irrevocable management trust cannot be as easily amended. Therefore, third parties are not able to induce a client to revise the trust. While many clients will not be willing to enter into such a trust, a client facing a possible guardianship may consider this a better option. Clients facing diminishing capacity may prefer to secure his or her estate plan to avoid attempted modifications or interference in the future. To avoid immediate transfer taxation, the trust can be drafted to give the client/trustor a "limited" general power of appointment. For example, the trustor may be able to exercise the power of appointment only in favor of his or her creditors.

As with all management trusts, the key is to transfer the majority, if not all, of the client's assets to the trust. The client should execute the necessary deeds and conveyances while he or she has the capacity to do so. The client's attorney-in-fact should also be expressly authorized to transfer the client's assets to the irrevocable trust. *See* discussion *supra.*

C. *Inter Vivos* Gifts

Inter vivos gifting continues to provide a simplistic way to transfer wealth to a client's intended beneficiaries and also reduce his or her estate for transfer tax purposes. However, the desire to transfer assets before a client's death to avoid interference must be balanced with the client's financial situation, desire for continued control, nature of assets, and associated professional fees.

1. Annual Exclusion Gifts

Annual exclusion gifts are a common method to transfer assets to desired beneficiaries before death. Some of the advantages include:

- Simplistic and inexpensive to implement;
- Gifted assets are generally not subject to transfer taxes at the client's death;
- May allow transfers to skip persons without subjecting them to generation-skipping transfer tax or use of the exemption;
- Removes asset from estate in the event of a will contest;
- Provides funds to a beneficiary to defend against a will contest after death;
- Interlopers may not be aware of such transfers; and
- Litigation costs incurred by interloper to recover gifted assets often exceeds value of gifted assets.

But, annual exclusion gifts are not the best option for every client. Disadvantages of annual exclusion gifts include:

- Loss of use/control of the assets;
- Can lead to disparity between gifts made to various family members or family lines depending on the number of beneficiaries of each child, etc.;
- Limited amounts can be gifted to each donee annually;
- Difficult to control use for a prolonged period of time; and
- Certain assets are not conducive to gifting.

2. Other Gifting Options

When a client desires continued control, other estate planning options may be more advantageous than annual exclusion gifts. With each option, consideration should be given to the type of asset involved and the extent of client's desire to retain control. A brief listing of common client objectives and possible options are as follows:

- Desire for income flow to client: Grantor Retained Annuity (or Unitrust) Trust and Charitable Remainder Trust;
- Desire to retain use of residence or second home for period of time: Qualified Personal Residence Trust;
- Desire to transfer non-control interest in business: Shares of a Family Limited Partnership;
- Desire to transfer life insurance: Life Insurance Trust;
- Desire to provide educational support: Texas Tomorrow Fund, 529 Plans, and Education Trusts; and
- Desire to provide for charities: Charitable Remainder Trusts and Foundations.

The retention of control also increases the likelihood of future conflicts. Therefore, the client should consider carefully whether the creation of an interest in a particular donee will lead to future interference or litigation. If so, care should be taken to include the option of the possible exclusion of the potential interloper in the future. *See* discussion *infra.*

D. Consider Advantages Of Partnerships Beyond Discounts

A partnership often provides a client an alternative means for the management of his

or her financial interest. A client can elect to create either a general or limited partnership and convey all of his or her assets to the partnership. Advantages of a partnership include:

- Allows grantor to maintain control by gifting limited partnership interests;
- Allows for management of assets in the event of incapacity or a will contest;
- Can be used to gain additional control of the client's sole or joint management community property;
- Can be used to inspire a spouse to make a widow's election;
- Provides some level of creditor protection, which may not be available with a self-settled or revocable management trust;
- Avoids the need for ancillary probate to transfer assets in other jurisdiction;
- Can include put and call options to force out potential interlopers;
- Can include arbitration agreements to resolve disputes;
- Can include indemnity provisions for fiduciaries; and
- May reduce transfer taxes (gift and death) due to applicable discounts.

A partnership is not the best option for every client. Some of the disadvantages of a partnership include:

- Level of required capacity to execute is generally higher than a will or even a trust;
- More expensive to create;
- Added complexity to manage assets;
- Need to file annual tax returns;
- Subject to greater scrutiny by IRS at the client's death;
- Client's agent may be stone-walled by the managing or general partner in the event of the client's incapacity;
- May convert separate property into community property – distributions are generally community even if partnership interest separate;
- Expose managing and/or general partner to claims of breach of fiduciary duty; and
- May result in loss of full basis adjustment due to discounts.

As with any of these proposed management tools, the client must balance the benefits of placing his or her assets in a partnership, which may be managed by another, with the control he or she wishes to retain for as long as he or she has capacity. Therefore, the partnership agreement should address:

The rules and responsibilities of the client, as a general partner, and the other limited partners with respect to the client's interest both during such time as he or she retains capacity and upon the incapacity of the client or any other partner;

- The right of a client's agent to be accepted into the partnership;
- The roles of each general or limited partner;
- The removal of a managing partner;
- The accountability of each partner to any other partner;
- The right of any partner to dissolve or terminate the partnership;
- Whether a partner has a duty to account to another partner's attorney-in-fact or trustee;
- Whether the partnership terminates on a client, or any other partner's, death or incapacity;
- Whether a client has a put or call option;
- Any restrictions on the transfer of the partnership interest;
- Whether disputes will be subject to arbitration or mediation; and
- When and under what conditions the partner may withdraw assets from the partnership.

E. Include Clear Distribution Standards

Distribution standards should be carefully drafted to avoid ambiguity, clarify preferences as between beneficiaries, and provide clear guidance to the fiduciary in making distributions. The ability to do so

often depends of the type of gifts and the related tax issues.

1. Marital Gifts

Marital gifts in trust often create issues due to the need to qualify for the unlimited marital deduction. To qualify as a QTIP, a trust must meet certain requirements including the distribution of all income. This may lead to conflicts between the distribution requirement of the spouse and the responsibilities to the remainder beneficiaries. Options to reduce conflicts may include:

- Express language regarding the ability to exhaust the trust in supporting the surviving spouse;
- Preferences as between the spouse and remainder beneficiaries;
- Allowing a trustee to make the discretionary principal distributions to spouse using an ascertainable or non-ascertainable standard;
- Including a unitrust or return trust standard;
- Clarifying whether a trustee must take into account other resources when making distributions of principal;
- Clarifying whether any applicable lifestyle standard is as of the client's death or at the applicable time;
- A spouse's rights of withdrawal; and
- Giving a spouse a power of appointment.

2. Non-Marital Gifts

Similar to marital trust, it is advisable to include provisions that reduce conflicts between various beneficiaries. Options to reduce conflicts may include:

- Clarifying a trustee's degree of discretion (i.e., may versus shall);
- Preferences as between the various beneficiaries;
- Allowing the trustee the ability to make discretionary income and principal distributions using an ascertainable or non-ascertainable standard;
- Clarifying whether a trustee must take into account other resources when making distributions of income and principal;
- Clarifying whether any applicable lifestyle standard is as of the client's death or at the applicable time;
- Educational incentives and objectives;
- Clarifying a trustee's ability to treat distributions as advancements;
- Distributions in satisfaction of a beneficiary's duty of support;
- Distributions during periods of minority, incapacity, commitment, divorce, or other conditions;
- Methods of payment; and
- Powers of appointment.

F. Include Comprehensive Fiduciary Provisions

Clear and comprehensive fiduciary provisions reduce the opportunity for interference by third parties or even courts. Furthermore, the more comfortable the fiduciary is with the scope of his or her role and the built-in protections, the greater the likelihood that he or she will continue to act in such capacity. Each instrument should be reviewed to confirm it includes comprehensive and workable provisions, including:

- The clear appointment of the necessary fiduciaries;
- Whether it appoints any trust advisors or protectors;
- Removal rights;
- Provisions to provide for subsequent appointments without court intervention;
- Clarification as to who can be appointed;
- Clarification as to the rights and powers of multiple fiduciaries;
- Process to allow dispute resolution between fiduciaries and beneficiaries;
- Provisions to allow or restrict the appointment of foreign fiduciaries;
- Provisions to allow or restrict the relocation of the situs of the trust, etc.;
- Provisions that provide suitable exoneration; and
- Provisions that provide appropriate indemnity provisions.

G. Build In Protection & Control

The selection of one or more estate planning techniques provides the framework for implementing the client's plan. To complete that framework, consideration should be given to building in future control and protection yet, at the same time, allowing for flexibility to modify terms to address future events and yet to be discovered opportunities.

1. Include Indemnity/Exoneration Provisions

An exculpation provision provides a potential or actual fiduciary with some level of comfort to exercise his, her or its discretion. By providing an appropriate level of exculpation, a fiduciary is encouraged to accept the appointment, even with foreseeably difficult beneficiaries, and also create a disincentive to a beneficiary seeking to threaten a fiduciary into acting in a certain manner. And, Texas generally upholds these provisions, except to those matters statutorily excluded. *See* TEX. PROP. CODE ANN. § 114.007 (Vernon 2007).

Indemnification clauses are, however, usually strictly construed. Therefore, the failure to draft clear indemnification, duty to defend, and hold harmless clauses can result in limited protection and unanticipated liability for the indemnity. Also, Texas law generally limits potential exoneration provisions. For example, Section 114.007 of the Texas Trust Code provides that a trustee cannot be exonerated for the following:

a. A term of a trust relieving a trustee of liability for breach of trust is unenforceable to the extent that the term relieves a trustee of liability for:
   (1) a breach of trust committed:
      (i) in bad faith;
      (ii) intentionally; or
      (iii) with reckless indifference to the interest of a beneficiary; or
b. Any profit derived by the trustee from a breach of trust.

TEX. PROP. CODE ANN. § 114.007 (Vernon 2007).

2. Address Power To Modify Or Revoke

As previously discussed, an agent under a power of attorney generally cannot modify or revoke a trust unless expressly authorized. Thus, the agent's authority to create, modify, or terminate a management trust should be clearly set out in the durable power of attorney. The agent may be granted broad discretion or allowed only to make non-dispositive modifications. At a minimum, the client should consider granting the agent sufficient authority to take advantage of potential transfer and income tax opportunity, such as modifying funding provisions to maximize basis adjustments. However, similar to a power of attorney, care should be taken to avoid creating a general power of appointment in the agent.

Likewise, when the client owns an interest in a partnership, the partnership should clarify the rights of any partner's agent to modify or withdraw for the partnership. It should also address the rights of the agent to act as a partner or whether his or her interest will be limited to that of an assignee.

a. Guardians.

A guardian generally cannot modify or revoke a trust unless expressly authorized. This is typically advisable in order to discourage attempts by third parties to use a guardianship proceeding to interfere with administration of the trust. The problem is that the appointment of a guardian may void a power of attorney and thus prevent the agent from taking advantage of potential transfer and income tax opportunity, such as modifying funding provisions to maximize basis adjustments. As a safeguard, the trust may provide that a guardian may be authorized to make certain limited modifications, or allow only certain selected persons, if appointed guardian, to effectuate such amendments or modifications.

When a partnership is involved, the partnership agreement should clarify the

rights of any partner's guardian to modify or withdraw for the partnership.

b. Others.

As discussed above, the appointment of a guardian may void a power of attorney and thus vacate an agent's powers. There are no such provisions with regard to trust protectors. Rather, they remain an ill-defined or understood role in Texas. This provides a planning opportunity. As a safeguard, the client may appoint one or more trust protectors and grant them the authority to modify or terminate a trust or limit their authority to make certain modification. *See* discussion *infra*.

3. Consider Trust Protectors And Advisors

The use of trust protectors in domestic trusts has increased over the last few years. While often used in offshore trusts, the use of trust protectors in domestic trusts provides a means to increase flexibility regarding future trust modifications and may add some additional protection for a trustee. However, the role of a trust protector remains ill-defined or understood in Texas. As discussed previously, the uncertainty provides a planning opportunity. As a safeguard, the client may appoint one or more trust protectors and grant them the authority to modify a trust or limit their authority to make certain modifications. Also, the trust protector can be used to appoint a trustee, remove a trustee, ratify decisions of the trust, terminate a trust, move a trust to another jurisdiction, or even insulate a trustee from liability. But, the uncertainty of the role also results in uncertainty as to the trust protector's potential liability to beneficiaries. Therefore, exoneration, indemnity, and arbitration provisions should expressly include protectors.

H. Provide For Reasonable Accountability

Provisions that clarify a fiduciary's duty to account often reduce future disputes. Therefore, consideration should be given to:

- The duty of a fiduciary to account;
- Whether the burden is on the fiduciary to provide an accounting periodically or whether the beneficiary must request an accounting;
- The type of accounting or information required;
- How often an accounting will or should be provided; and
- How the cost of the accounting will be allocated.

Note that the failure of a fiduciary to comply with accounting requirements may lead to claims of breach of trust and grounds for removal. Therefore, provisions placing the obligation on the fiduciary to provide an accounting to certain beneficiaries regardless of a request should be made clear to the fiduciary to avoid an inadvertent breach of his or her duty.

I. Plan For Capacity Disputes

One of the most difficult provisions to draft relates to defining when the client will be considered to be incapacitated. A determination of incapacity may result in the authority for an attorney-in-fact to act under a power of attorney, the removal of a client as trustee of his management trust, or the payment of trust distributions to persons other than the client. Provisions dealing with a client's incapacity must provide a process to determine when the client has become incapacitated. They should also allow the client to manage and control his or her affairs for so long as reasonably possible.

1. Include Definition Of Incapacity

Every trust agreement generally provides a method for the appointment and removal of trustees. Typically, the grantor serves as trustee or co-trustee until he or she resigns or becomes incapacitated. Unfortunately, many trust agreements do not provide a definition of incapacity, provide for the removal of a trustee while the grantor is incapacitated, or address the authority of the grantor's attorney-in-fact in matters relating to the trust. Each of these considerations should be addressed in the trust agreement. *See* discussion *infra*.

a. Client's Incapacity

One of the most difficult provisions to draft relates to defining when the client will be considered to be incapacitated. A determination of incapacity may result in the authority for an attorney-in-fact to act under a power of attorney, the removal of a client as trustee of his management trust, or the payment of trust distributions to persons other than the client. Provisions dealing with a client's incapacity must provide a process to determine when the client has become incapacitated with the right of the client to manage and control his or her affairs for so long as reasonably possible.

To avoid an issue of when a client is "incapacitated," estate-planning documents should define when a client, trustee, or relevant party is incapacitated for purposes of enforcing the terms and provisions of the document at issue. The grantor may further restrict the proceeding standard by requiring a specific physician or the selected physician to be board certified in neurology or psychiatry in order to certify a grantor or trustee as being incapacitated.

b. Beneficiary's Incapacity

A determination of a beneficiary's capacity is sometimes more difficult because he or she has typically not executed the trust agreement or otherwise entered into a contractual relationship that authorizes the disclosure of the beneficiary's medical or mental health information. Therefore, a determination of a beneficiary's incapacity should be drafted to provide the trustee greater flexibility when a physician cannot certify the beneficiary's capacity.

2. Include Notice Provisions

In the event of a beneficiary, trustee, or any other interested individual's incapacity, the instrument at issue should provide a means to notify certain individuals of such person's incapacity. These provisions create at a minimum the perception of responsibility on a client, children, spouses, grantor, trustee, or beneficiary, to notify appropriate individuals of the potential incapacity.

Furthermore, documents such as powers of attorney and trust agreements should provide a means for the principal or beneficiary to designate one or more persons who should serve as their designated representative for purposes of receiving notices, reports, or other information during any period that they may be incapacitated. As discussed previously, a power of attorney may require that the agent notify and provide information to a client's spouse, financial advisor, or other designated individuals. *See* discussion *supra*. A trust may include a provision that requires a trustee to notify a minor or incapacitated beneficiary's parents or legal guardian of any information, reports, or accountings to be provided under the trust agreement.

3. Include A Procedure To Avoid Disputes Based On Capacity

If possible, documents should provide a general means to avoid disputes based on a client, fiduciary, or beneficiary's capacity. These provisions provide a method to mitigate disputes and resolve differences in a less adversarial manner. Furthermore, the courts will generally enforce the terms of the contract provided they are not void as a matter of law or against public policy. Arbitration provisions can provide a valid process in which parties may resolve these disputes outside a public litigation. Possible processes to resolve or avoid disputes based on incapacity may be as follows:

- Arbitration provisions, *see* discussion *infra*;
- Presumption of capacity unless the person at issue has been adjudicated to be incapacitated by a guardianship proceeding in the State of Texas;
- Presumption of capacity unless two or more doctors certify that such person lacks the requisite capacity; and
- Requirement that the person in issue submit to a mental and physical exam within 30 days of written request by a trustee, agent or client, or be presumed to be incapacitated for purposes of the governing document.

4. Consider Signing A HIPPA Release

Consideration should be given to whether the appropriate person is able to receive relevant medical information due to the enactment of Health Insurance Portability and Accountability Act of 1996. For example, a trustee, trustee appointer, or trust protector may be given a limited purpose HIPPA authorization form to allow him or her to request relevant medical information.

J. Consider Including Provisions That Discourage Litigation

1. Attorney Fee And Expenses Allocation Clauses

Similar to debt and tax allocation clauses, it is important to consider how legal fees and expenses should be allocated between and among beneficiaries. The instruments should address whom and under what circumstances such fees and expenses will be allocated against a particular beneficiary's share or interest. The instrument may also limit the circumstances when a beneficiary can seek reimbursement for his or her legal fees. *See* Donaho, Offensive and Defensive Estate Planning, State Bar of Texas 25th Annual Estate Planning and Probate Course, June 2001.

2. Powers of Appointment

Powers of appointment (a/k/a powers of disappointment or redirection) remain one of the most commonly utilized tools to dissuade interference by beneficiaries. Generally, any beneficiary has standing to question or challenge a trustee's actions. That desire is often tempered when the beneficiary can be summarily removed from the plan. But, the right to remove can also lead to the exclusion of intended beneficiaries. Thus, the powers of appointment should be drafted and included in a manner that promotes the client's overall intent.

Furthermore, a person with a general power of appointment has the ability to release a trustee from actions or liability under the Texas Trust Code. *See* TEX. PROP. CODE ANN. § 114.032(b) (Vernon 2007). This may provide additional protection to the trustee from potential claims by tentative beneficiaries.

3. No Contest Clauses

Most estate planning lawyers are generally familiar with the use of no contest clauses in wills. Less often, no contest clauses have been used effectively to avoid disputes involving the dispositive provisions of a trust. A no contest clause does not, however, have to be limited to dispositive provisions of an instrument. Rather, Texas law recognizes that no contest provisions can be drafted as broadly or narrowly as the testator or grantor deems appropriate. Provided the no contest clause is specific and direct in its intent, Texas courts will often enforce these provisions. But, a provision may not be enforced if the contestant is found to have challenged the instrument in good faith.

Notwithstanding the recent enactment, a client may consider using a no contest provision to avoid interference both during his lifetime and at his death. A no contest provision in a will or trust may be expanded to provide that if any named beneficiary challenges any action of the client's attorney-in-fact, under her duly executed power of attorney, or a trustee, pursuant to a trust created by the client, the interfering beneficiary's interest under the will and trust shall be void. Although arguably not necessary, it would be preferable to require that the challenged client's agent or trustee be required to give written notice of the no contest clause to the potential heir and that the potential heir be allowed a reasonable period of time in order to withdraw his challenge, contest, or other means of interfering with the client's designated agents and representatives. Furthermore, a no contest provision should be drafted in a manner that balances the interest of the client to avoid interference, with the ability of third parties to raise valid complaints should an agent, trustee, or executor, be using the no contest provision as a sword instead of a shield.

4. Arbitration Clauses

Arbitration continues to provide parties an alternative forum in which to settle disputes and often avoids unwanted publicity or disclosures associated with a public proceeding. To be binding, parties must contractually agree to submit their disputes to arbitration in lieu of, or in addition to, other remedies available under Texas law. In the past decade, arbitration procedures have been routinely included in agreements involving business associations such as partnerships, employment, purchase and sale, and professional services agreements. Until recently, there was no Texas law specifically addressing an arbitration clause in a trust agreement. In a case of first impression, the Dallas Court of Appeals held that an arbitration clause in the trust agreement at issue was not enforceable. *See Rachal v. Reitz*, 347 S.W.3d 305 (Tex.App.—Dallas 2011)(pet. filed). But in so doing, the appellate court noted that:

> [W]e determine the existence of an arbitration agreement based on Texas contract law. *J.M.* Davidison, 128 S.W.3d at 227. The elements required for the formation of a valid contract are (1) an offer, (2) acceptance in strict compliance with the terms of the offer, (3) a meeting of the minds, (4) each party's consent to the terms, and (5) execution and delivery of the contract with the intent that it be mutual and binding on the parties to the agreement. *Gables Cent. Constr*., 2009 WL 824732, at *2. Consideration is a fundamental element of every valid contract. *Id.*

Id. at 309.

The *Rachal* court referenced similar decisions reached in California in 2011 and Arizona in 2004. *See Diaz v. Bukey*, 195 Cal.App.4th 315, 125 Cal.Rptr.3d 610, 611–13, 615 (2011)(as issue of first impression, California appellate court held trust beneficiary who did not agree to arbitrate disputes arising under trust may not be compelled to arbitrate because a trust is not a contract); *Schoneberger v. Oelze*, 96 P.3d 1078 (Ariz. 2004). But, the Arizona legislature subsequently passed a statute which allowed the enforcement of arbitration provisions in trust when reasonable. *See* ARIZ. REV. STAT. ANN. § 14–10205 (West) (stating "[a] trust instrument may provide mandatory, exclusive and reasonable procedures to resolve issues between the trustee and interested persons or among interested persons with regard to the administration or distribution of the trust").

K. Coordinate, Coordinate, Coordinate

Fundamental to every estate plan is coordination of the client's techniques and assets. Lack of coordination often leads to litigation. And, it is particularly important when the plan may be challenged.

1. Coordinate Estate Planning Vehicles

One of the most important characteristics of an estate plan is that it meets the client's overall objectives. When various estate planning techniques or options are used, it is vitally important that an attempt is made to coordinate the entire plan. The failure to coordinate often leads to future disputes and disappointment. Therefore, assets should be reviewed to confirm that it is clear which assets are subject to each vehicle. The provisions of a power of attorney, a trust, and/or a partnership should be reviewed to confirm the rights and limitations of each fiduciary with respect to the others. All dispositive provisions should also be analyzed to confirm the amount passing to each beneficiary before and after the payment of transfer taxes and debts.

Likewise, documents should be reviewed to coordinate the proper exercise or non-exercise of any *inter vivos* or testamentary powers of appointment. When necessary, the exercise should include the required specific references to avoid claims of ineffective exercise.

2. Coordinate Assets

As discussed previously, the advantages of various estate planning techniques are

premised on the transfer of assets to such vehicles. To obtain the maximum benefit, the intended assets must be controlled by the proper vehicle. Furthermore, by passing clear title to the entity or fiduciary, there is a reduction in the amount of assets that may be subject to a guardianship proceeding or will contest. Efforts should be made to coordinate and transfer the various assets to the selected trust or partnership. In some cases, this can be accomplished by listing the assets on an attached exhibit to the relevant document and stating that such assets have been conveyed to the respective entity. This approach should be used with caution because it will often lead to future disputes regarding ownership and control between one or more fiduciaries – for example an agent and a trustee. Thus, real estate should be conveyed by deeds, accounts should be restyled with the financial institution, and title to tangible personal property should be confirmed by appropriate transfer documents or at a minimum a bill of sale.

3. Coordinate Gifts Powers

If future gifts are a possibility, the governing documents should grant the power to make gifts and coordinate the various fiduciaries rights and powers to implement a gift program. For example, the ability to make gifts under a power of attorney is useless if all the assets have been transferred to a management trust and the trustee refuses to distribute assets to effectuate the contemplated gifts. Furthermore, a trustee may be concerned about being sued for breach of fiduciary duty when the instrument does not authorize him or her to distribute trust assets to allow for the gifts planned by the agent. Thus, consideration should be made to:

- Who has authority to make gifts;
- How the gift can be made;
- Whether the agent has the authority to request distributions from a trust for purposes of implementing a gifting program;
- The liability or exoneration of a trustee in distributing such either to the agent or the designated donee;
- The right or power of a trustee to make gifts; and
- Inclusion of crummy powers.

4. Coordinate And Utilize Debt And Tax Allocation Clauses

It is important to coordinate the payment of debts and transfer taxes. The instruments should clarify how debts and death taxes should be allocated between and among non-probate assets, specific bequests, marital and charitable beneficiaries and residuary gifts.

Alternatively, the use of a tax and debt allocation clause may be beneficial in allowing selected beneficiaries to receive certain assets tax and debt free, while requiring others to take any remaining property subject to such debts and expenses. For example, a potential will contestant may be misled into believing that he or she will receive a significant portion of a decedent's estate and, therefore, not challenge a will, only to learn that the majority of the probate assets will be required to satisfy the death taxes due to the inclusion of non-probate assets passing to the intended beneficiary.

L. Plan For A 'Defense' Fund

To the extent the client anticipates potential litigation regarding his or her estate plan, consideration should be given to how the fiduciary or other party will be able to fund his or her defense.

1. Lifetime Gifts

As discussed above, lifetime gifts may provide an intended beneficiary sufficient funds to retain counsel to pursue the probate of a client's will, or defend other estate planning options. However, given the expense of litigation, the beneficiary may or may not have received or retained sufficient funds to fully fund the anticipated cost.

2. Life Insurance

Life insurance may be used to provide a beneficiary initial funds to retain counsel to

pursue the probate of a client's will, or defend other estate planning options. However, if the client recently changed the beneficiary designation, the contestant may be successful in convincing a court or even the insurance company to suspend the release of the death benefit pending a challenge.

3. Funded Trusts

A funded trust can often provide the proponent of a client's estate plan the funds to defend the client's estate plan. The terms of a trust should be drafted to authorize the trustee to either engage counsel to defend the will, or other estate planning options, or to make distributions to the proponent to engage counsel to defend the will, or other estate planning options. However, a contestant may attempt to enjoin the trustee from making distributions pending a challenge to the validity of the trust.

4. Right of Survivorship Accounts

Similar to life insurance, a right of survivorship account may be used to provide a beneficiary initial funds to retain counsel to defend against potential litigation. However, if the client recently created or changed the beneficiary designation, the contestant may be successful in convincing a court to enjoin the release of the account pending a challenge over the validity of the designation.

5. Savings Bonds

Savings bonds can provide an effective means for a beneficiary to generate initial funds to retain counsel. Federal savings bonds can be issued in the name of the client and another person. Upon the client's death, the ownership passes by federal statute to the other named person. As they are governed by federal law, third parties and even courts are less inclined to enjoin the sale of such bonds by the named beneficiary.

M. Communicate

Regardless of the relationship involved, communication is one of the most effective means of reducing potential conflicts and complaints. Misconceptions regarding a particular person's standing in the family or perceived closeness to the client can lead to future surprise or disbelief regarding the client's estate planning choices. If possible, the client should attempt to communicate his or her desires to his assumed beneficiaries.

Likewise, the client's intentions should be made clear to his or her fiduciaries. Fiduciaries should be encouraged to communicate with all beneficiaries including advising beneficiaries of their appointment, establishing preferred means of communication, and making efforts to periodically communicate.

VI. WAYS TO REDUCE CONFLICT DURING ADMINISTRATION.

A. Consider Whether To Accept Or Decline Serving

Every appointed fiduciary should first consider whether to accept the job. The fiduciary must initially decide whether he or she has the knowledge and skills to carry out his or her duties, and whether he or she has the time to attend to them. If so, the fiduciary should identify the person or persons he or she will owe duties and responsibilities to, and whether these individuals are reasonable or unreasonable. The instrument should clearly define the involved persons either by individual or class. If these persons appear to have litigious tendencies, the fiduciary should strongly consider declining because --- as they say --- no good deed goes unpunished.

Furthermore, the governing instrument should be carefully reviewed to determine if it provides the proposed fiduciary both guidance and reasonable exoneration and protection from unwarranted claims. Also, some provisions may adversely affect the fiduciary when attempting to carry out his or her duties. For example, a power to remove a trustee is sometimes exercised in retaliation to a fiduciary disagreeing with a beneficiary's request for a discretionary distribution. If the instrument is drafted in a manner that will hamper a fiduciary from fulfilling his or her role, the fiduciary should consider declining to serve.

Finally, a fiduciary may be appointed in various roles that could create conflicting responsibilities, duties or powers. The fiduciary should consider whether he, she or it should decline to act in certain capacities to avoid future claims and conflicts.

B. Review Governing Documents

The will, trust, power of attorney, etc., at issue generally sets out the duties, powers, and obligations of the fiduciary. These governing instruments provide the terms of the fiduciary's "contract" with the testator, settlor, or principal. By agreeing to serve, the fiduciary ostensibly agrees to follow and adhere to these terms. Thus, one of the first actions of a fiduciary should be to read, and re-read, the governing documents. These documents provide the direction and road map enabling the fiduciary to stay on course. If the terms or provisions are not clear, the fiduciary should consider filing a declaratory judgment action seeking judicial construction.

C. Understand Applicable Standard Of Care

1. Trustees

A trustee must invest and manage the trust in compliance with the prudent investor rule. TEX. PROP. CODE ANN. § 117.003 (Vernon 2007). *See* discussion *infra.*

2. Personal Representatives

A personal representative must act as a prudent man would in caring for his own property. TEX. ESTATES CODE § 351.101.

3. Guardians

A guardian of the estate has the duty to act and manage the ward's estate as a prudent person would manage the person's own property, except as otherwise provided by the Texas Estates Code. TEX. ESTATES CODE § 1151.151.

4. Agents

The Texas Estates Code sections dealing with powers of attorney do not specifically set out a standard of care for an agent. The statute does, however, set out specific rules of construction and powers generally as they pertain to real estate, tangible personal property, stock and bonds, commodity and options, banking and other financial institutions, business operations, insurance, estate, trust and other beneficiary transactions, claims and litigation, personal and family maintenance, governmental programs, military service, retirement plans, and tax matters. *See* TEX. ESTATES CODE §§ 752.101-752.114. In at least one other state, an agent has been described as a fiduciary who must observe the standards of care applicable to trustees. Further, if the exercise of the power of attorney is improper, the agent is liable to interested persons for damage or loss resulting from the breach of fiduciary duty to the same extent as the trustee of an express trust. *See Conseco Ins. Co. v. Clark*, 2006 WL 2024402 (M.D. Fla. 2006)(unpublished opinion). It is possible that the definition set forth in the Florida statute is adopted in Texas.

D. Balance Multiple Interests

Executors and trustees are often faced with the task of balancing various and sometimes divergent interests. A fiduciary should be careful not to favor one interest over another unless expressly authorized by the governing instrument. *See* TEX PROP. CODE ANN. § 117.008 (Vernon 2007)("trustee shall act impartially in investing and managing the trust assets, taking into account any differing interests of the beneficiaries"). A classic example arises when a fiduciary considers investment decisions and returns on investments. Sometimes an investment may generate a larger degree of return for the income beneficiary and a smaller return for the remainderman.

But, trustees generally do not owe fiduciary duties to third parties or those that may indirectly benefit from the terms of the instrument, such as an individual to whom a beneficiary owes a duty of support. Therefore, in exercising his or her discretion, the fiduciary's primary concern should be what is in the best interest of the beneficiaries of the instrument. *See* TEX PROP. CODE ANN.

§ 117.008 (Vernon 2007)("trustee shall invest and manage the trust assets solely in the interest of the beneficiaries").

E. Exercise Discretion

Paramount to the exercise of discretion is that the trustee must actually act to "exercise" his, her or its discretion. *See Sassen v. Tanglegrove Townhouse Condominium Ass'n*, 877 S.W.2d 489 (Tex. App.—Texarkana 1994, writ denied) (agent required to exercise reasonable discretion). A fiduciary that establishes a process of determining how they intend to exercise his, her or its discretion is less subject to challenge than a fiduciary with no process in place. Thus, trustees that can present a well thought out and reasonable decision-making process for distributions are often victorious, even if their decisions appear to contradict the language of a trust, i.e. *Penix v. First National Bank of Paris*, 260 S.W.2d at 63, or the clear intent of the settlor, i.e., *Coffee v. Rice*, 408 S.W.2d 269 (Tex. 1966).

1. Gather Relevant Information

In order to properly exercise his or her discretion, a fiduciary cannot make decisions in a vacuum. The fiduciary will generally need to obtain information from the beneficiary in order to make a fully informed distribution decision. Furthermore, a beneficiary may require certain information from the fiduciary in order to properly assess whether to make a distribution request and understand the manner in which the fiduciary decides to exercise his or her discretion.

a. Information From Beneficiary

Perhaps one of the more difficult issues is the information that a trustee feels he or she requires to justify a distribution. Some trustees desire to obtain extensive information from the beneficiary to "paper" their file, however, this can lead to feelings of ill-will and invasion of privacy towards the trustee. Other trustees go to the opposite extreme and request no information. This can lead to claims of breach of fiduciary duty against the trustee by the other beneficiaries who may eventually request that the trustee justify his or her prior distributions. In acting, "the trustee generally may rely on the beneficiary's representations and on readily available, minimally intrusive information requested of the beneficiary." But when the trustee has reason to believe that the information is incomplete or inaccurate, the trustee should request additional information.

Relevant additional information may include the living expenses of the beneficiary and under the general rule of construction, what other resources are reasonably available to the beneficiary for his support. Information that is commonly requested by trustees include the following:

- Income and cash flow information;
- Financial statements;
- Copies of all trust documents under which the beneficiary has a right to funds or request a distribution;
- Copies of tax returns;
- Copies of all tuition and similar agreements relating to the beneficiaries' education and maintenance;
- Copies of receipts or invoices as to any amounts to be reimbursed;
- Information regarding a beneficiary's employment status and efforts to obtain such employment;
- Status of the beneficiaries' housing, medical insurance, and any other information regarding their support that the trustees deem relevant; and
- Notification of any significant changes in any beneficiary's housing, education, development or medical needs.

While the preceding is not intended to be an exhaustive list or required in all situations, it provides a general listing of the information that may be periodically requested by a trustee to consider distribution requests and carry out the terms of the trust.

b. Information From Trustee

Information regarding distributions is a two-way street. Just as a trustee may seek

information to support a distribution, a beneficiary is entitled to information in order to request a distribution or justify a trustee's decisions whether to make a distribution. The Restatement (Third) of Trusts provides that among a trustee's fiduciary duties is the (i) general duty to act, reasonably informed, with impartiality among the various beneficiaries and interests (Section 79) and (ii) duty to provide the beneficiaries with information concerning the trust and its administration (Section 82). The Restatement concludes "this combination of duties entitles the beneficiaries (and also the court) not only to accounting information but also to relevant, general information concerning the bases upon which the trustee's discretionary judgments have been or will be made. *See* RESTATEMENT (THIRD) OF TRUSTS § 50 cmt g (general observations on relevant factors in the interpretation of discretionary powers).

2. Understand Applicable Distribution Standards

It is the duty of the personal representative upon appointment to take reasonable care of all estate property as a prudent man would do except for extraordinary casualties. *See* TEX. ESTATES CODE § 351.101; *Roberts v. Stewart*, 80 Tex. 379, 15 S.W. 1108 (1891); *Radford v. Coker*, 519 S.W.2d 934 (Tex. Civ. App.--Waco 1975, writ ref'd n.r.e.). The personal representative's duty is to collect all assets, claims, debts due, personal property, records, books, title papers, and business papers of the estate and hold them for delivery to those entitled when the estate is closed. *See* TEX. ESTATES CODE §§ 351.102, 351.151; *Atlantic Ins. Co. v. Fulfs*, 417 S.W.2d 302 (Tex. Civ. App.--Fort Worth, 1967, writ ref'd n.r.e.).

The duties of a personal representative are essentially the same as that of a trustee and the same standard of care applies to both fiduciaries. *See McLenden v. McLenden*, 862 S.W.2d 662 (Tex. App. – Dallas 1993, writ denied). Similar to a trustee, a personal representative has a duty to protect the interests of the heirs or beneficiaries' interest by "fair dealings in good faith with fidelity and integrity." *Id.* And, the personal representative's interest cannot conflict with her fiduciary obligations to the decedent's estate. *See Id.*

F. Comply With Applicable Statutory Guidelines

1. Texas' Uniform Principal And Income Act

Effective January 1, 2004, Texas enacted the Uniform Principal and Income Act. *See* TEX. PROP. CODE ANN. § 116.001 *et seq.* (Vernon 2007). And, it generally applies to both existing trusts and trusts established after January 1, 2004. *See* Section 5(b) of the Acts of 2003, 78th Leg, ch. 659. But, do not be deceived by its title. Like the new Uniform Principal and Income Act, some provisions mirror the Uniform Acts, other are tailored to Texas and every trustee and their advisors should be familiar with the new requirements.

In short, the Texas Principal and Income Act generally imposes extensive rules. And, while these new provisions may be overridden by clear directions to the contrary in the trust agreement, with regard to existing trusts a preemption will be difficult to establish. For example, the new adjustment provisions provide that trust provisions relating to adjustments of principal and income do not affect the new adjustment powers unless the terms "are intended to deny the trustee the power of adjustment conferred by Subsection (a)." TEX. PROP. CODE ANN. § 116.005(f) (Vernon 2007).

Included in the new provisions is the ability to make adjustments between principal and income and general rules when doing so. Specifically, Texas Trust Code Section 116.005 permits the trustee to make adjustments between principal and income when:

- The trustee considers the adjustment necessary;
- The trustee invests and manages trust assets as a prudent investor;
- The terms of the trust describe the amount that may or must be distributed to a beneficiary by referring to the trust's income; and

- The trustee determines, after applying the rules in Section 116.004(a)(relating to a trustee's fiduciary duties), that the trustee is unable to comply with Section 116.004(b)(i.e., impartiality except as modified by trust).

TEX. PROP. CODE ANN. § 116.005 (Vernon 2007).

In determining whether and to what extent to exercise the adjustment power, a trustee is *required* to consider all factors relevant to the trust and its beneficiaries, including the following statutory factors to the extent they are applicable:

- The nature, purpose, and expected duration of the trust;
- The intent of the settlor;
- The identity and circumstances of the beneficiaries;
- The needs for liquidity, regularity of income, and preservation and appreciation of capital;
- The assets held in the trust including, the extent to which they consist of financial assets, interests in closely held enterprises, tangible and intangible personal property, or real property, the extent to which an asset is used by a beneficiary, and whether an asset was purchased by the trustee or received from the settlor;
- The net amount allocated to income under the other sections of the new Principal and Income Act and the increase or decrease in the value of the principal assets, which the trustee may estimate as to assets for which market values are not readily available;
- Whether and to what extent the terms of the trust give the trustee the power to invade principal or accumulate income or prohibit the trustee from invading principal or accumulating income, and the extent to which the trustee has exercised a power from time to time to invade principal or accumulate income;
- The actual and anticipated effect of economic conditions on principal and income and effects of inflation and deflation; and
- The anticipated tax consequences of an adjustment.

TEX. PROP. CODE ANN. § 116.005(b) (Vernon 2007).

And, the new Act also provides limitations on the power to adjust. These limitations are generally imposed to prevent the loss of certain tax opportunities. Specifically, a trustee may not make an adjustment that:

- Diminishes the income interest in a trust that requires all of the income to be paid at least annually to a spouse and for which an estate tax or gift tax marital deduction would be allowed, in whole or in part, if the trustee did not have the power to make the adjustment;
- Reduces the actuarial value of the income interest in a trust to which a person transfers property with the intent to qualify for a gift tax exclusion;
- Changes the amount payable to a beneficiary as a fixed annuity or a fixed fraction of the value of the trust assets;
- Relates to an amount that is permanently set aside for charitable purposes under a will or the terms of a trust unless both income and principal are so set aside;
- Will cause an individual to be treated as the owner of all or part of the trust for income tax purposes, and the individual would not be treated as the owner if the trustee did not possess the power to make an adjustment; and
- Will cause all or part of the trust assets to be included for estate tax purposes in the estate of an individual who has the power to remove a trustee or appoint a trustee, or both, and the assets would not be included in the estate of the individual if the trustee did not possess the power to make an adjustment.

TEX. PROP. CODE ANN. § 116.005(c) (Vernon 2007).

And, finally the fiduciary and his advisors should be familiar with Texas Trust Code Sections 116.151 through 116.206 that address the receipt and distribution of a number of specific assets and distributions. These new sections replace former Sections 113.101 through 113.111. These provisions should be reviewed carefully to confirm understanding of these new default provisions. A brief summary of the more common receipts includes:

- Section 116.151 addresses receipts from business entities. Care should be taken when "money" or cash is received as the new provisions characterize some such receipts as income and others as principal. Generally, money is allocated to income unless it is related to a partial or total liquidation or it meets certain capital gain requirements. Other receipts are generally allocated to principal;
- Section 116.152 addresses receipts from another estate or trust. It provides that a distribution of income from a trust or an estate in which the trust has an interest (other than a purchased interest) shall be allocated to income and amounts received as a distribution of principal are principal;
- Section 116.162 provides for the allocation of receipts from rental property. Generally, it provides that the following are allocated to income (i) rents related to real or personal property; and (ii) amount received for cancellation or renewal of a lease. The following are allocated to principal (i) an amount received as a refundable deposit, including a security deposit; and (ii) a deposit that is to be applied as rent for future periods;
- Section 116.163 provides for the allocation of receipts from debt or similar obligations. Generally, it provides that the following are allocated to income: (i) an amount received as interest (whether fixed, variable, or floating rate); (ii) an amount received as consideration for prepaying principal without any provision for amortization of premium; and (iii) as to obligations held for less than one year, an amount in excess of the purchase price or original debt obligation. The following are allocated to principal: (i) as to obligations held for more than one year, an amount received from the sale, redemption, or other disposition of a debt obligation, including an obligation whose purchase price or value when it is acquired is less than its value at maturity; and (ii) as to obligations held for less than one year, an amount equal to the purchase price or original debt obligation;
- Section 116.172 provides that distributions of up to 4% of the value of the plan or IRA in any one year is income and any excess is principal. This section will replace Section 113.109 that provided that of each receipt, five percent was considered income, based on inventory value, recalculated each year; and
- Section 116.174 provides that a trustee is required to allocate these receipts "equitably," and allocating in accordance with the available federal tax depletion deduction is presumed to be equitable; provided, however, an exception exists for existing trusts. Trustees of existing trusts may continue to apply the old allocation rules of 72-½ % of royalties being allocated to income and the remaining 27-½ % to principal.

TEX. PROP. CODE ANN. § 116.151 *et seq.* (Vernon 2007).

2. Texas' Uniform Prudent Investor Act

Effective January 1, 2004, Texas enacted the Uniform Prudent Investor Act. *See* TEX. PROP. CODE ANN. § 117.001 *et seq.* (Vernon 2007). But, do not be deceived by its title. Like the new Uniform Principal and Income Act, some provisions mirror the Uniform Acts, other are tailored to Texas and every trustee and their advisors should be familiar with the new requirements.

The enactment of the Texas Uniform Prudent Investor Act has resulted in significant changes to the default rules relating to the allocation of trust receipts and disbursements as between principal and income. And, unlike the prior provisions of the Texas Trust Code, some of the sections now apply to decedent's estates.

Texas Trust Code Section 117.004 sets for the general duties and considerations of a prudent investor as follows:

a. A trustee shall invest and manage trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill, and caution.

b. A trustee's investment and management decisions respecting individual assets must be evaluated not in isolation but in the context of the trust portfolio as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the trust.

c. Among circumstances that a trustee shall consider in investing and managing trust assets are such of the following as are relevant to the trust or its beneficiaries:
   1. general economic conditions;
   2. the possible effect of inflation or deflation;
   3. the expected tax consequences of investment decisions or strategies;
   4. the role that each investment or course of action plays within the overall trust portfolio, which may include financial assets, interests in closely held enterprises, tangible and intangible personal property, and real property;
   5. the expected total return from income and the appreciation of capital;
   6. other resources of the beneficiaries;
   7. needs for liquidity, regularity of income, and preservation or appreciation of capital; and
   8. an asset's special relationship or special value, if any, to the purposes of the trust or to one or more of the beneficiaries.

d. A trustee shall make a reasonable effort to verify facts relevant to the investment and management of trust assets.

e. Except as otherwise provided by and subject to this subtitle, a trustee may invest in any kind of property or type of investment consistent with the standards of this chapter.

f. A trustee who has special skills or expertise, or is named trustee in reliance upon the trustee's representation that the trustee has special skills or expertise, has a duty to use those special skills or expertise.

TEX. PROP. CODE ANN. § 117.004 (Vernon 2007).

Furthermore, new Section 117.005, now requests that a trustee diversify investments "unless the trustee reasonably determines that, because of special circumstances, the purposes of the trust are better served without diversifying." TEX. PROP. CODE ANN. § 117.005 (Vernon 2007). And, a trustee now has an affirmative duty to "review the trust assets and make and implement decisions concerning the retention and disposition of assets, in order to bring the trust portfolio into compliance with the purposes, terms, distribution requirements, and other circumstances of the trust, and with the requirements of this chapter" within a reasonable period of time of being appointing or receiving additional assets. TEX. PROP. CODE ANN. § 117.006 (Vernon 2007).

G. Understand The Delegation Limitations

Most fiduciaries cannot delegate their fiduciary powers and duties. But, one notable

exception exists as the trustees. Effective September 1, 1999, the Texas Trust Code was amended to specifically permit a trustee to employ an investment agent, in addition to employing attorneys, accountants, agents, and brokers reasonably necessary in the administration of the trust estate. *See* TEX. PROP. CODE ANN. § 113.018 (Vernon 2007). With the enactment of the Prudent Investor Act, Section 113.018 was revoked and Section 117.011 was enacted to replace it. *See* TEX. PROP. CODE ANN. § 117.011 (Vernon 2007). Section 117.011 permits a trustee to delegate investment and management decisions to an agent if certain conditions are met, and subject to certain limitations.

Specifically, a trustee may now delegate investment and management functions that a "prudent trustee of comparable skill could properly delegate under the circumstances." But, when doing so, the trustee must:

- Select an agent with reasonable care, skill and caution;
- Establish the scope and terms of obligation with reasonable care, skill and caution; and
- Periodically review the agent's actions in order to monitor the agent's performance and compliance with the terms of the delegation with reasonable care, skill, and caution.

If done properly, the trustee cannot be held liable for the decisions and actions of the duly engaged agent. Note that any limitations on the trustee's liability do not alleviate the agent's liability to the trust. Section 117.001(b) expressly provides that an agent owes a duty to the trust to exercise reasonable care to comply with the terms of the delegation. But, a trustee cannot, however, avoid liability for the actions of its agent when:

- The agent is an affiliate (see new definition) of the trustee;
- The delegation agreement requires arbitration; or
- The delegation agreement shortens the statute of limitation.

Still, the new Texas delegation standard should be easier for trustees to meet than the former delegation provisions.

H. Communicate

As previously discussed, communication is perhaps one of the most effective tools to avoid misunderstandings that lead to potential claims and lawsuits against fiduciaries. Many lawsuits are filed due to the failure of a fiduciary to (i) inform a beneficiary of his or her interest, (ii) meet with beneficiaries, (iii) discuss the basis for his or her decisions, (iv) provide status reports, or (v) disclose relevant information and periodic accounts during the relationship.

While a fiduciary does not have to involve the beneficiaries or principal in every decision, the fiduciary should, at a minimum, advise the beneficiary or interested person of his or her interest, provide a means to contact the fiduciary, provide periodic information, and advise all interested persons of significant events, in a timely manner. If possible, a fiduciary such as a trustee should attempt to periodically meet with each beneficiary to address any issues or concerns. By building a personal relationship, the fiduciary can both better fulfill his or her job while also mitigating potential litigation that arises from feelings of exclusion. The fiduciary's counsel should, however, not engage in communications that create or appear to create an attorney-client relationship between the beneficiary and the fiduciary's attorney.

I. Keep Good Books And Records

An executor, trustee, guardian, or agent has a duty to maintain complete books and records relating to his or her actions and administration. Therefore, the fiduciary should establish an organized system to maintain the books and records at the onset of the relationship and continue to maintain them during the administration. It is preferable to maintain detailed financial records that reflect all assets on hand, all sources and uses of cash, all receipts, all distributions, and all investments. Utilizing one of the various financial computer

programs is one of the most effective and least costly means to maintain up-to-date books and records. And, the fiduciary should maintain all such information for the duration of the relationship or entity at issues.

J. Provide Periodic Accountings

It is advisable for a fiduciary to provide periodic accountings to all interested persons. Accountings not only allow a fiduciary to comply with his or her duty of disclosure, they also often commence the statute of limitations with regard to transactions adequately disclosed on the statements. Corporate fiduciaries generally provide accountings monthly or quarterly. An individual fiduciary should consider providing an accounting at least annually. Regardless of the period covered, an accounting should reflect all receipts and disbursements, and allocate each, as receipt or expenditure to income or principal. The type of accounting depends on the fiduciary relationship.

1. Trustees

Some trust agreements require a trustee to periodically provide some or all the beneficiaries a periodic accounting. To the extent required by the terms of the trust, the trustee should provide the requisite beneficiaries an accounting that complies with the time and content of the mandated accounting. The failure to meet these requirements can be held to be a breach of trust.

Furthermore, regardless of whether the trust mandates an accounting requirement, a beneficiary can generally request an accounting from the trustee. Section 113.151 provides as follows:

> A beneficiary by written demand may request the trustee to deliver to each beneficiary of the trust a written statement of accounts covering all transactions since the last accounting or since the creation of the trust, whichever is later. If the trustee fails or refuses to deliver the statement on or before the 90th day after the date the trustee receives the demand or after a longer period ordered by a court, any beneficiary of the trust may file suit to compel the trustee to deliver the statement to all beneficiaries of the trust. The court may require the trustee to deliver a written statement of account to all beneficiaries on finding that the nature of the beneficiary's interest in the trust or the effect of the administration of the trust on the beneficiary's interest is sufficient to require an accounting by the trustee. However, the trustee is not obligated or required to account to the beneficiaries of a trust more frequently than once every 12 months unless a more frequent accounting is required by the court. If a beneficiary is successful in the suit to compel a statement under this section, the court may, in its discretion, award all or part of the costs of court and all of the suing beneficiary's reasonable and necessary attorney's fees and costs against the trustee in the trustee's individual capacity or in the trustee's capacity as trustee.

See TEX. PROP. CODE ANN. § 113.151(a) (Vernon 2007).

If requested, the trustee is required to prepare and provide an accounting that complies with Section 113.152 of the Texas Property Code. The form of the accounting requires a written statement of accounts that shows:

- All trust property that has come to the trustee's knowledge or into the trustee's possession, and that has not been previously listed or inventoried as trust property;
- A complete account of receipts, disbursements, and other transactions regarding the trust property for the period covered by the account, including their source and nature, with receipts of principal and income shown separately;

- A listing of all property being administered, with an adequate description of each asset;
- The cash balance on hand and the name and location of the depository where the balance is kept; and
- All known liabilities owed by the trust.

See TEX. PROP. CODE ANN. § 113.152 (Vernon 2007).

If the trustee fails to provide the requested accounting, any "interested person" may file suit to compel the trustee to account to the interested person. *See* TEX. PROP. CODE ANN. § 113.151(c) (Vernon 2007). And, the court may require the trustee to deliver an accounting once the court finds the interested person has a valid interest in the trust, such as being a beneficiary, having a claim against the trust, or other interest that would be sufficient to require an accounting by the trustee. *See* Id.

Finally, as previously discussed, a trustor may not limit "any common-law duty to keep a beneficiary of an irrevocable trust who is 25 years of age or older informed at any time during which the beneficiary: (1) is entitled or permitted to receive distributions from the trust; or (2) would receive a distribution from the trust if the trust were terminated." TEX. PROP. CODE ANN. 111.0035(c) (Vernon 2007). Therefore, any attempts to override the accounting requirement for a person over 25 who meets the statutory requirements should be ignored.

2. Personal Representatives

With regard to an independent personal representative, a beneficiary can demand an accounting fifteen months after his, her or its appointment. Once demanded, the independent personal representative has sixty days from the receipt of the request, to prepare and provide an accounting that complies with Section 404.001 of the Texas Estates Code. The accounting must be sworn and subscribed by the independent personal representative and set forth, in detail, the following information:

- The property belonging to the estate that has come into the executor's hands;
- The disposition that has been made of such property;
- The debts that have been paid;
- The debts and expenses, if any, still owing by the estate;
- The property of the estate, if any, still remaining in the executor's hands;
- Such other facts as may be necessary to a full and definite understanding of the exact condition of the estate; and
- Such facts, if any, that show why the administration should not be closed and the estate distributed.

See TEX. ESTATES CODE § 404.001.

With regard to a dependent personal representative, they are required to file an annual accounting, until discharged, which includes the following information:

a. All property that has come to his knowledge or into his possession not previously listed or inventoried as property of the estate.
b. Any changes in the property of the estate which have not been previously reported.
c. A complete account of receipts and disbursements for the period covered by the account, and the source and nature thereof, with receipts of principal and income to be shown separately.
d. A complete, accurate and detailed description of the property being administered, the condition of the property and the use being made thereof, and, if rented, the terms upon and the price for which rented.
e. The cash balance on hand and the name and location of the depository wherein such balance is kept; also, any other sums of cash in savings accounts or other form, deposited subject to court order, and the name and location of the depository thereof.

f. A detailed description of personal property of the estate, which shall, with respect to bonds, notes, and other securities, include the names of obligor and obligee, or if payable to bearer, so state; the date of issue and maturity; the rate of interest; serial or other identifying numbers; in what manner the property is secured; and other data necessary to identify the same fully, and how and where held for safekeeping.

g. A statement that, during the period covered by the account, all tax returns due have been filed and that all taxes due and owing have been paid and a complete account of the amount of the taxes, the date the taxes were paid, and the governmental entity to which the taxes were paid.

h. If any tax return is due to be filed or any taxes due to be paid are delinquent on the filing of the account, a description of the delinquency and the reasons for the delinquency.

i. A statement that the personal representative has paid all the required bond premiums for the accounting period.

TEX. ESTATES CODE § 359.001.

3. Agents

An agent has a duty to account to his or her principal regarding actions taken on the principal's behalf. Due to ongoing concerns, Texas Estates Code Chapter 751 was enacted in 2001 (former Section 489B) to impose a statutory duty to account. TEX. ESTATES CODE § 751.101; *see also* Tex. H.B. 1883, 77th Leg., R.S. (2001) (effective 9/1/01). Texas Estates Code Sections 751.101-751.106provides as follows:

a. The attorney in fact or agent is a fiduciary and has a duty to inform and to account for actions taken pursuant to the power of attorney.

b. The attorney in fact or agent shall timely inform the principal of all actions taken pursuant to the power of attorney. Failure of the attorney in fact or agent to inform timely, as to third parties, shall not invalidate any action of the attorney in fact or agent.

c. The attorney in fact or agent shall maintain records of each action taken or decision made by the attorney in fact or agent.

d. The principal may demand an accounting by the attorney in fact or agent. Unless otherwise directed by the principal, the accounting shall include:

1. the property belonging to the principal that has come to the attorney in fact's or agent's knowledge or into the attorney in fact's or agent's possession;
2. all actions taken or decisions made by the attorney in fact or agent;
3. a complete account of receipts, disbursements, and other actions of the attorney in fact or agent, including their source and nature, with receipts of principal and income shown separately;
4. a listing of all property over which the attorney in fact or agent has exercised control, with an adequate description of each asset and its current value if known to the attorney in fact or agent;
5. the cash balance on hand and the name and location of the depository where the balance is kept;
6. all known liabilities; and
7. such other information and facts known to the attorney in fact or agent as may be necessary to a full and definite understanding of the exact condition of the property belonging to the principal.

e. Unless directed otherwise by the principal, the attorney in fact or agent shall also provide to the principal all documentation regarding the principal's property.
f. The attorney in fact or agent shall maintain all records until delivered to the principal, released by the principal, or discharged by a court.
g. If the attorney in fact or agent fails or refuses to inform the principal, provide documentation, or deliver the accounting within 60 days (or such longer or shorter time that the principal demands or a court may order), the principal may file suit to compel that the principal demands or a court may order), the principal may file suit to compel the attorney in fact or agent to deliver the accounting, to deliver the assets, or to terminate the power of attorney.
h. This section shall not limit the right of the principal to terminate the power of attorney or to make additional requirements of or to give additional instructions to the attorney in fact or agent.
i. Wherever in this chapter a principal is given an authority to act that shall include not only the principal but also any person designated by the principal, a guardian of the estate of the principal, or other personal representative of the principal.
j. The rights set out in this section and chapter are cumulative of any other rights or remedies the principal may have at common law or other applicable statutes and not in derogation of those rights.

TEX. ESTATES CODE §§ 751.101-751.106; *see also* Tex. H.B. 1883, 77th Leg., R.S. (2001) (effective 9/1/01) (emphasis added).

But, Sections 751.101-751.106 were not intended to limit the principal's ability to impose additional requirements on or instructions to his or her attorney-in-fact. Therefore, a durable power of attorney may also include additional provisions relating to his or her agent's duty to account and inform. For example, a client may require his agent to account not only to the client's representatives but also to his or her spouse and the spouse's representatives, including the spouse's guardian or attorney-in-fact. An agent may also be required to keep certain family members, financial advisors, or other individuals designated by the client, informed and apprised of the agent's activities on behalf of the principal. The power of attorney should be reviewed to determine if any additional reporting or accounting requirements were included.

K. Consistency Matters

A fiduciary should attempt to be consistent when carrying out his or her duties and responsibilities in order to avoid claims of unauthorized preference or abuse of discretion. For example, a trustee is often required to exercise his or her "discretion" when managing assets or deciding whether to distribute assets to or between one or more beneficiaries. The governing instrument may provide some guidance by setting out a distribution standard: health, education, maintenance and support. Even so, the fiduciary should generally attempt to be consistent with regard to determinations as between beneficiaries (such as what is appropriate for support or maintenance) unless the instrument expressly provides otherwise.

L. Document, Document, Document

Almost every fiduciary has a duty to account for his or her actions if called on to do so. Many trusts impose standards that require the trustee to determine a beneficiary's (i) current or past standard of living to set a benchmark for trust distributions, (ii) assets available for his or her support, or (iii) income available for his or her own support. In order to provide adequate accounts or defend prior decisions, every fiduciary should maintain detailed files on his or her actions and decisions. Requests for distributions should be made, if possible, in writing, and include a description of the

reason for the requested distribution. Written invoices should support expenses paid by the trust. When appropriate, the fiduciary should place a memo or note in the file to document notable issues. All records should be maintained until the fiduciary is released or discharged.

M. Understand Standards Of Judicial Review

Likewise, it is important to recognize how a decision may be reviewed if it becomes the subject of litigation.

1. Common Law

There are two basic principles that can be derived from the case law in Texas. They allow courts the latitude to take whatever action they deem necessary according to the facts in each situation. The first principle is that courts will not second guess the fiduciary unless there is an "abuse of discretion." *Coffee*, 408 S.W.2d at 269. This rule is still valid today; "Texas courts are prohibited by law from interfering with the discretion of the trustee absent a clear showing of fraud or other egregious conduct." *In re Bass*, 171 F.3d 1016 (5th Cir. 1999). The second principle is that any decision by the fiduciary that subverts the "intent of the settlor" will be overturned. *See State v. Rubion*, 308 S.W.2d at 4.

The logical conclusion to be drawn from these two principles is that the "intent of the settlor" is the paramount consideration when a fiduciary is exercising its discretion. A closer look at these seemingly clear principles reveals that the courts have not actually provided any real guidance. The case law only leads the fiduciary to the place in which it started. After all, if the settlor's intent is abundantly clear to all parties then there would be no need for court intervention in the first place. Furthermore, it is apparent from reading the actual cases that settlor's intent is often in reality second fiddle to a trustee's discretion. *See Coffee*, 408 S.W.2d at 269. While this line of thinking does not serve those of us who would like better guidance in this area, it does allow the courts the freedom to evaluate either principle on a case-by-case basis. Thereby granting the courts a position of authority whether they uphold the trustee's decision, or the complaining plaintiff's allegation of foul play.

Currently, fiduciaries have only one clear mandate. Any action taken should conform to the creator's intent, as expressed in the governing instrument. Unfortunately, determining the creator's intent, or rather what the court will accept as the creator's intent, is a difficult undertaking. As discussed, the primary source for determining a creator's intent is the governing instrument. Still, the courts will consider a number of factors outside of the instrument when (in the determination of the court) the instrument itself is not clear.

The lack of clarity in this area does not make life any easier for a fiduciary that is faced with a tough decision. On the other hand, the entire purpose for having a fiduciary of a "discretionary trust" is to burden the fiduciary with the responsibility of making decisions based on future events, and to have the benefit of the fiduciary's judgment and discretion. *In Re Shea's Will*, 254 N.Y.S. 512 (1931). The lack of clarity also explains why the case law is so sparse. Trial courts have wide latitude under the rules as they stand now, and appellate courts have not as of yet devised any better guidance.

a. Context Of Review

Generally, the review arises either in the context of a beneficiary seeking to compel or prohibit distributions (*see generally*, *Rubion*, *supra*) or a creditor seeking to reach the assets of the trust. *See*, *Penix v. First National Bank of Paris*, 260 S.W.2d at 63.

b. Extent Of Review

The extent that courts are willing to intervene in the administration of a trust is dictated by the two principles of law discussed above. Courts in Texas are free to intervene in the administration of trusts under *Rubion*, and free to wash their hands of trust administration when they see fit under *Coffee*. *Coffee*, 408 S.W.2d at 269. Therefore, it can

reasonably be inferred that courts are likely to intervene when the facts of a particular case offend the court's sensibilities, and likely to cite *Coffee* or its progeny when the courts are agreeable to the decisions the trustee has made. *See Id.*

2. Texas Trust Code

Until the enactment of Texas' version of the Uniform Principal and Income Act in 2004, there was limited statutory authority for a court to review a trustee's distribution decisions. For example, the Texas Trust Code provided that a district court (and statutory probate courts under their enabling legislation) had jurisdiction over all proceedings concerning trusts, including those relating to (i) making determinations of fact that affect distributions from a trust, (ii) determining a question arising in the distribution of a trust, and (iii) relieving a trustee from any or all of the duties, limitations, and restrictions otherwise existing under the terms of the trust instrument or of this subtitle. *See* TEX. PROP. CODE ANN. § 115.001(a) (Vernon 2007). The Texas Trust Code, however, did not provide any additional guidance.

Thus, trustees and beneficiaries generally sought relief under the declaratory judgment provisions set forth in the Texas Civil Practice & Remedies Code. *See* TEX. CIV. PRAC. & REM. CODE ANN. § 37.005 (Vernon Supp. 2011)(person interested in a trust may seek judicial declaration of rights or legal relations in respect to trust to direct the trustees to do or abstain from doing any particular act in their fiduciary capacity or determine any question arising in administration of trust).

Now, Texas Trust Code Section 116.006 provides for judicial review of a trustee's decisions relating to adjustments to income, which may directly or indirectly affect a trustee's distribution decisions. Texas Trust Code Section 116.006 allows a trustee to seek a court declaration (in certain cases) that a contemplated adjustment will not be a breach of trust. There are limitations on a trustee's right to pursue such a determination. Furthermore, Section 116.006 addresses the payment of a trustee and beneficiary's legal fees relating to a judicial proceeding. Section 116.006 requires the trustee to advance attorney's fees related to the proceeding from the trust; however, it also permits the court to charge these fees between or among the trust, the trustee, individually, or one or more beneficiaries (or their trust interests), at the conclusion of the proceeding based on the circumstances.

Before a trustee considers initiating a judicial proceeding, it is advisable to determine if a non-judicial means exists to resolve any issues involving a contemplated principal/income adjustment. Section 116.006 requires that before a trustee may initiate a judicial proceeding: (i) a trustee makes reasonable disclosure to all beneficiaries and (ii) have a reasonable belief that a beneficiary will object to the proposed allocation. Some means to determine if an objection exists may include:

- Written notification of the proposed allocation to all trust beneficiaries including, clear communication as to the effect of the allocation (reduced principal, etc.);
- Request that the beneficiary advise the trustee if he objects or consents to the distribution;
- Request that the beneficiary indicate his or her consent in writing (perhaps provide written consent forms); and
- Inform beneficiaries that if they have any questions, they should seek counsel before signing any documents or responses.

Note, the refusal of a beneficiary to sign a waiver or release is not reasonable grounds for a trustee to claim that the beneficiary will object to the adjustment or allocation. *See Id.*

N. Terminating The Relationship

A fiduciary relationship may terminate either due to (i) the removal of the fiduciary, (ii) the fulfillment of the terms of the trust or estate, or (iii) the resignation of the fiduciary. Regardless, once the relationship is

terminated, the former fiduciary should seek to settle his or her accounts and, if possible, resolve any pending issues. For example, the Restatement of Trusts provides that a former trustee is authorized to wind-up his or her affairs and retain authority to do so. Therefore, a former fiduciary should consider whether they have entered into any contractual relationships that need to be resolved. Further, if a trustee is removed, the trustee should consider notifying the other trust beneficiaries so that they will know whom to contact regarding trust matters.

O. Settling Fiduciary Accounts

A fiduciary is generally not required to wait for years to determine if someone is going to bring a claim against them relating to his or her administration. Rather, a fiduciary can generally seek to settle his or her accounts with the successor trustee, beneficiaries, or other appropriate person or entity. Often this can be accomplished in a non-judicial manner by accounting to the appropriate person and seeking a non-judicial release. For example, the Texas Trust Code was amended as of September 1, 1999, to allow trust beneficiaries to enter into binding releases. If, however, the beneficiary or other persons have raised claims regarding the accounting or refuse to execute the requested releases, the fiduciary should generally seek to judicially settle his or her accounts. A trustee may do so pursuant to the Texas Trust Code and the Texas Civil Practice and Remedies Code. An independent executor may also do so pursuant to recent amendments to the Texas Estates Code.

VII. OTHER CONSIDERATIONS.

A. Recognize That Almost Anything May Be Discoverable And Act And Write Accordingly

Because of the nature of the fiduciary relationship, it is possible virtually any document could be discovered (rightly or wrongly) in litigation. Thus, it should never be presumed that any written communication would be protected from disclosure. Perhaps no form of communication has raised more issues in the last few years than emails. As this form of communication is rapidly becoming the norm with many clients, they have become a favorite of litigators. Furthermore, individuals have a tendency to say things in email that they would not say in more formal communications, including personal comments that can be taken out of context in subsequent litigation. Thus, every document should be written in a manner that assumes that a potential adverse litigant may read it in the future.

B. Be Clear Who The Advisor Represents

With regard to attorneys, the existence of an attorney-client relationship may be either express or implied from the parties' conduct. *See Perez v. Kirk & Carrigan*, 822 S.W.2d 261, 265 (Tex. App.—Corpus Christi 1991, writ denied). Once established, the attorney-client relationship gives rise to corresponding duties on the attorney's part. It is not inconceivable that this premise can create the same duties as to the other fiduciaries advisors. Thus, an advisor engaged by a fiduciary should be careful never to unintentionally create the impression that he or she represents or is advising a beneficiary, creditor or other third party. These impressions can be formed via meetings, letters and other communications with third parties. Ways to reduce such potential claims include the following:

- Any meetings should be preceded with a statement that the advisor only represents the fiduciary;
- A written notice of non-representations can be given to any potential beneficiaries and creditors in the initial letter or contact;
- An acknowledgement of no representation may be requested before any meetings with the third parties;
- The advisor should not generally answer any questions regarding the third parties' rights; and
- Documents to be signed by the third party should not be prepared by the advisor, if possible.

While the preceding list is not exclusive or even mandatory, these reflect efforts to reduce claims made in actual proceeding over the past few years.

C. Be Careful In All Written Communications With Beneficiaries & Third Parties

It is common when representing a fiduciary to communicate with the beneficiaries of the estate or trust on the fiduciary's behalf. These contacts may create, however, a claim that the beneficiary, creditor, etc., believed that the professional advisor owes a duty to the beneficiary, creditor, etc. Thus, it is suggested that any written communication with any potential non-client reiterate (i) who the advisor represents, and (ii) that the advisor does not represent the recipient.

Furthermore, it is advisable for fiduciary advisors to avoid preparing documents, such as waivers, disclaimers, etc., for non-clients. However, given the realities of the estate and trust area, it is sometimes necessary for the fiduciary's advisor to prepare such documents to expedite his or her appointment or the settlement of the estate or trust. If the attorney is providing the non-client a document for execution, the correspondence should clearly suggest that the recipient have the document reviewed by his or her own advisors. Finally, any letter to a potential beneficiary should be written, if possible, in a manner that confirms, each time, that the advisor is not providing advice to the recipient.

D. Avoid Making Alleged Representations And Use Disclaimers Of Reliance When Appropriate

It is common for interested parties to request that a fiduciary make certain express representations to verify certain facts or conditions. Representations may be used to confirm assets, liabilities, past events or other matters that an interest party deems relevant to an estate or trust. While such information is needed or even mandatory to meet certain fiduciary duties, the attorney or other advisor for the fiduciary should avoid being the one making such representations. When he or she does, and it turns out to be incorrect, the attorney or other advisor may face claims of negligent misrepresentation.

Furthermore, the Texas Supreme Court has sanctioned the use of disclaimers of reliance in documents to mitigating potential claims of reliance or negligent misrepresentation. *See Schlumberger Technology Corp. v. Swanson*, 959 S.W.2d 171 (Tex. 1997); *Atlantic Lloyds Insurance Company v. Butler*, 137 S.W.3d 199 (Tex. App.—Houston [1st Dist.] 2004, pet. filed July 6, 2004)(disclaimer of reliance in settlement agreement conclusively negated other parties alleged reliance on any representations or lack of disclosure by other parties). A disclaimer of reliance may provide as follows:

> Each party confirms and agrees that such party (i) has relied on his or her own judgment and has not been induced to sign or execute this Agreement by promises, agreements or representations not expressly stated herein, (ii) has freely and willingly executed this Agreement and hereby expressly disclaims reliance on any fact, promise, undertaking or representation made by the other party, save and except for the express agreements and representations contained in this Agreement, (iii) waives any right to additional information regarding the matters governed and effected by this Agreement, (iv) was not in a significantly disparate bargaining position with the other party, and (v) has been represented by legal counsel in this matter.

E. Consider the Possible Rights Of Successor Fiduciaries

Attorneys and other advisor's representing a fiduciary should consider that an issue exists regarding the right and privity of a successor fiduciary to the agents of the prior fiduciary. When a fiduciary has been

removed or died, a successor fiduciary is generally imposed with a duty to redress his or her predecessor's actions. When a fiduciary is represented by counsel, the question then becomes whether the successor is entitled to the predecessor's legal files. While the Texas Supreme Court decision of *Huie v. DeShazo*, 922 S.W.2d 920 (Tex. 1996), seems to imply that the attorney only represented that fiduciary/client, no Texas court has clearly addressed this issue in the context of an estate, or guardianship and at least one trial court has ordered the turnover of the prior attorney's files.

Until this issue is decided, an attorney or other advisor for a former fiduciary should request the consent of the client or the client's representative's before releasing his or her files to a successor fiduciary. If consent cannot be obtained, the advisor should request a court order compelling the turn over.

F. Be Cognizant Of The Discovery Rule

While the standard statute of limitation on breach of fiduciary duty is four years, the discovery rule can toll this applicable period for years into the future. The Texas Supreme Court has twice held a fiduciary's misconduct to be inherently undiscoverable. *See Willis v. Maverick*, 760 S.W.2d 642, 547 (Tex. 1988) (attorney-malpractice actions subject to discovery rule because of fiduciary relationship between attorney and client and client's lack of actual or constructive knowledge of injury); *Slay v. Burnett Trusts*, 187 S.W.2d 377, 394 (1945) (trustee). The discovery of such claims may relate the fiduciary's actions or inactions. As a result, consideration should be given to retaining files and other information or documentation relevant to these engagements far beyond the standard period.

G. Take The High Road

Finally, common sense probably provides the best guide to avoiding fiduciary related litigation. When representing a fiduciary, both the fiduciary and his or her attorney (as the fiduciary's agent) appear to be held to a higher standard. Thus, care should be taken by both in carrying out their respective roles. Some final suggestions include:

- Avoid "Rambo" litigation;
- Be cognizant of a fiduciary's duties of disclosure;
- Do not allow fiduciary-client to use attorney's services to enable a clear breach of his or her duties;
- Consider when to put matters in writing and when not to – even to the fiduciary; and
- Appropriate payment and segregation of fees and expense;

VIII. CONCLUSION

In short, fiduciary litigation will never be eliminated. But, professional advisors can often reduce potential litigation through careful planning and taking certain actions during the duration of the fiduciary relationship. Hopefully, the proceeding discussion provides some guidance during the process.