

**HANDBOOK FOR THE FIDUCIARY
ADVISING AND COUNSELING TRUSTEES**

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HANDBOOK FOR THE FIDUCIARY

I. DUTIES OF A TRUSTEE

A. Texas Trust Code Section 113.051

The Texas Trust Code provides that the trustee shall "administer the trust according to its terms and [The Texas Trust Code]. In the absence of any contrary terms of the trust instrument or contrary provisions of [The Texas Trust Code], in administering the trust the trustee shall perform all of the duties imposed on the trustees by the common law." Tex. Prop. Code Ann. §113.051 (Vernon's 1984). All references to the Texas Trust Code are to the Texas Trust Code, which is codified in Article 9 of the Texas Property Code.

B. Common Law

Case law has categorized fiduciary duties in various ways, but generally, they fall into four main categories: (1) duty of loyalty, (2) duty of competence, (3) duty to reasonably exercise discretion, and (4) duty of full disclosure. For a comprehensive discussion of fiduciary duties, see MOORE, FIDUCIARY LITIGATION TRIAL HANDBOOK 2000, 24th Annual Advanced Estate Planning and Probate Course.

Probably the most famous, and eloquent, description of a "fiduciary" was made by Justice Cardozo in the case of Meinhard v. Salmon, 249 N.Y. 458, 164 N.E. 545-46, 62 A.L.R. 1 (1928):

Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A (fiduciary) is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the "disintegrating erosion" of particular exceptions. ... Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd.

The following is a discussion of the general fiduciary duties owed by a trustee that have been well established under the common law.

1. DUTY OF LOYALTY

The duty of loyalty is the hallmark of a fiduciary relationship. The trustee must at all times place the interests of the beneficiary above his own. Slay v. Burnett Trust, 187 S.W.2d 377 (Tex. 1945). The trustee is not permitted to "place himself in a position where it would be for his own benefit to violate his duty to the beneficiaries." (Section 170, FRATCHER, SCOTT ON TRUSTS (Fourth Ed. 1989) ("SCOTT")). See also Section 170 of the RESTATEMENT (SECOND) OF TRUSTS, (the "RESTATEMENT"). A trustee who utilizes or takes trust property for his own benefit is considered to be "self-dealing." Any self-dealing by a fiduciary will give rise to a "presumption of unfairness," and the burden of proving the fairness of the transaction is placed on the fiduciary. Texas Bank and Trust Co. v. Moore, 595 S.W.2d 502 (Tex. 1980); Pace v. McEwen, 574 S.W.2d 792 (Tex. Civ. App.— San Antonio 1978, writ ref'd n.r.e.); Jochev v. Clayburne, 863 S.W.2d 516 (Tex. App.—Austin 1993, writ denied).

Texas Trust Code Section 117.007 expressly provides that a trustee shall invest and manage the trust assets solely in the interest of the beneficiaries.

Section 117.008 expressly requires a trustee to act impartially in investing and managing trust assets if the trust has two or more beneficiaries, taking into account any differing interests of the beneficiaries. See also SCOTT and the RESTATEMENT, Section 183.

2. DUTY OF COMPETENCE

The Trustee has an affirmative duty to administer the trust. TEX. PROP. CODE §§ 113.006 and 113.051. The fundamental duties of a trustee include the use of the skill and prudence which an ordinary, capable and careful person would use in the conduct of his own affairs. Interfirst Bank Dallas, N.A. v. Risser, 739 S.W.2d 882, 888 (Tex. App. –Texarkana 1987, no writ). The duty of competence encompasses many “sub-duties,” some of which are described below.

a. Duty to Comply With Prudent Investor Rule

Effective January 1, 2004, the Texas Trust Code has adopted the “prudent investor” rule. Texas Trust Code §117.003 provides that a trustee owes a duty to the beneficiaries of the trust to comply with the prudent investment rule, unless altered by the provisions of the trust. The standard of care for the prudent investor is stated in Texas Trust Code §117.004 as follows:

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.

A trustee’s investment decisions regarding individual assets must be evaluated in the context of the trust portfolio as a whole and as part of an overall strategy having risk and return objectives reasonably suited to the trust. See Section II *infra*.

b. Duty Not to Delegate

The trustee is generally obligated to personally administer the trust and cannot delegate to others acts that the trustee should personally perform. See Section 171 of SCOTT and the RESTATEMENT. There are exceptions to this rule.

A trustee may employ attorneys, accountants, agents, including investment agents, and brokers reasonable necessary in the administration of the trust estate. TEX. PROP. CODE § 113.018. A trustee also may delegate investment decisions under certain circumstances. TEX. PROP. CODE §117.001. See Section II.A.7. *infra*.

c. Duty to Keep and Render Accounts

A trustee is under a duty to the beneficiaries of a trust to keep full accounts of the trust estate that are clear and accurate. Section 172 of SCOTT and the RESTATEMENT. A beneficiary may demand a written statement of accounts covering the trust's transactions. TEX. PROP. CODE §113.151.

d. Duties at Inception of Trusteeship

Within a reasonable time after receiving trust assets, a trustee shall review the trust assets 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 the Texas Trust Code. TEX. PROP. CODE §117.006.

e. Duty to Exercise Reasonable Care and Skill

For matters other than investments, "a trustee is under a duty in administering the trust to exercise such care and skill as a man of ordinary prudence would exercise in dealing with his own property." See SCOTT, Section 174. See also the RESTATEMENT, Section 174.

f. Duty to Take and Retain Control of Trust Property

The trustee is under a duty to take all reasonable steps to obtain and control the trust property. See SCOTT and the RESTATEMENT, Section 175.

g. Duty to Preserve Trust Property

A trustee must use the same care and skill that a person of ordinary prudence would use to preserve trust property. See SCOTT and the RESTATEMENT, Section 176.

h. Duty to Enforce Claims

A trustee is under a duty to take reasonable actions to collect claims that are due to the trust estate. See Section 177, SCOTT and the RESTATEMENT.

i. Duty to Defend

The trustee is under a duty to do what is reasonable, under the circumstances, to defend actions by third parties against the trust estate. See Section 178, SCOTT and the RESTATEMENT.

j. Duty Not to Co-Mingle Trust Funds

The trustee has a duty to keep trust property separate from other property, and to properly designate it as trust property. Not only is it the trustee's duty to keep the trust property separate from the trustee's own property, but also to keep that property separate from other trusts the trustee may administer. See Section 179 of SCOTT and the RESTATEMENT. Joint investments may be proper, but each trust's interest must be kept separate.

k. Duty With Respect to Bank Deposits

Although a trustee may deposit funds in a bank, he is under a duty to use reasonable care in selecting the bank and to properly designate the deposit as a trust deposit. He may not subject the deposit to unreasonable restrictions on withdrawal or leave the property in non-interest bearing accounts for unduly long periods of time. See Section 180 of SCOTT and the RESTATEMENT. See also Section 113.007 of the Texas Trust Code, which authorizes the trustee to deposit trust funds that are "being held pending investment, distribution, or the payment of debts in a bank that is subject to supervision by state or federal authorities."

l. Duty With Respect to Co-Trustees

Unless the trust provides otherwise, all trustees are under a duty to participate in the trust administration. Therefore, a trustee cannot properly delegate the acts required of the trustee to co-trustees. It is also the duty of a trustee to use reasonable care to prevent other trustees from committing a breach of trust. See Section 184 of SCOTT and the RESTATEMENT.

3. DUTY OF FULL DISCLOSURE

A fiduciary has an affirmative duty to make a full and accurate disclosure of all material facts. *Montgomery v. Kennedy*, 669 S.W. 2d 309 (Tex. 1984), *Kinszbach Tool Co. Inc. v. Corbett-Wallace Corp.*, 160 S.W.2d 509 (Tex. 1942). The rationale for this rule is described by William E. Fratcher, *Scott On Trusts*, §173 (Fourth Edition):

The trustee is under a duty to the beneficiaries to give them on their request at reasonable times complete and accurate information as to the administration of the trust. The beneficiaries are

entitled to know what the trust property is and how the trustee has dealt with it. They are entitled to examine the trust property and the accounts and vouchers and other documents relating to the trust and its administration. Where a trustee is created for several beneficiaries, each of them is entitled to information as to the trust. Where the trust is created in favor of successive beneficiaries, a beneficiary who has a future interest under the trust, as well as a beneficiary who is presently entitled to receive income, is entitled to such information, whether his interest is vested or contingent.

A trustee has a fiduciary duty, upon demand by the beneficiary, to furnish the beneficiaries with a formal trust accounting; to inform a beneficiary of the nature and amount of the trust property, the trustee's management actions, and the intent of the trustee regarding the future administration of the trust estate; and to allow the beneficiary to inspect the books and records of the trust. Shannon v. First National Bank, 533 S.W.2d 389 (Tex. Civ. App. 1976, writ ref'd, n.r.e.); and Section 173 of SCOTT and the RESTATEMENT. The fiduciary duty of full disclosure operates before and after litigation has been filed and is in addition to any obligations of disclosure imposed by the "discovery" provisions of the Texas Rules of Civil Procedure. Huie v. DeShazo, 922 S.W.2d 920 (Tex. 1996); In re Peterson, 2004 WL 88872 (Tex. App. – Amarillo). For a detailed discussion of a trustee's duty of disclosure, see IKARD, DISCLOSURE BY A FIDUCIARY/TRUSTEE OUTSIDE FORMAL DISCOVERY: NON-TRADITIONAL RULES AND ALTERNATIVE METHODS, 1999 Advanced Estate Planning and Probate Course.

In 2005, The Texas Legislature enacted Texas Trust Code §113.060, effective January 1, 2006, which required a trustee to keep trust beneficiaries reasonably informed concerning (1) the administration of the trust; and (2) the material facts necessary for the beneficiaries to protect their interests. Recognizing problems with the provision, it was repealed effective June 15, 2007. Accordingly, trustees operate under the common law duty of disclosure.

4. DUTY TO REASONABLY EXERCISE DISCRETION.

A trustee must exercise a discretionary power "reasonably." See Sassen v. Tanglegrove Townhouse Condo. Assoc., 877 S.W.2d 489 (Tex. App.–Texarkana 1994, writ denied). Effective January 1, 2004, Texas enacted the Uniform Principal and Income Act of 1997. Former Trust Code §§113.101 through 113.111 have been repealed. The Uniform Principal and Income Act is contained in Chapter 116 of the Texas Property Code. In exercising a discretionary power of administration regarding a matter covered by the Uniform Principal and Income Act, "a fiduciary shall administer a trust or estate impartially, based on what is fair and reasonable to all of the beneficiaries, except to the extent that the terms of the trust or the will clearly manifest an intention that the fiduciary shall or may favor one or more of the beneficiaries. A determination in accordance with this chapter is presumed to be fair and reasonable to all of the beneficiaries. TEX. PROP. CODE §116.004(b).

a. Power to Adjust Between Principal and Income.

New Texas Trust Code §116.005 authorizes a trustee to adjust between principal and income if the trustee is in compliance with the prudent investor rule, the trust provides for distributions to a beneficiary by reference to the trust's "income" and the trustee cannot otherwise administer the trust impartially, based on what is fair and reasonable to all of the beneficiaries. The power to adjust specifically includes the power to allocate all or part of a capital gain to trust income. This section lists nine factors that a trustee may consider in deciding whether or how to exercise the power to adjust and prohibits a trustee from making an adjustment under certain circumstances.

b. Judicial Control of Discretionary Power.

New §116.006 provides that a court may not question a trustee's exercise or non-exercise of the power to adjust unless the court determines that the decision was an abuse of the trustee's discretion. If a court determines that a trustee has abused its discretion, the court may place the income and remainder beneficiaries in the positions that they would have occupied if the discretion had not been abused. TEX. PROP. CODE §116.006(c). If the trustee reasonably believes that one or more beneficiaries will object to the exercise of a discretionary power, the trustee may petition the court to determine whether the proposed discretionary act will result in an abuse of the trustee's discretion. TEX. PROP. CODE §116.006(d). In such a suit, the trustee is directed to advance from the trust principal all costs incident to the judicial determination, including attorney's fees of the trustee, any beneficiary who is a party and any guardian ad litem. At the conclusion of the proceeding, however, the court may award costs and attorney's fees as the court deems to be "equitable and just" as provided in Texas Trust Code §114.064, including awarding costs against the trust, a beneficiary and/or the trustee in its individual capacity if the court determines that the trustee's exercise of the discretionary power would have resulted in an abuse of discretion or that the trustee did not have reasonable grounds for believing that a beneficiary would object.

The remaining sections of the Uniform Principal and Income Act generally provide for allocation of specific receipts and disbursements between income and principal. For a detailed discussion of these provisions, see KARISCH, TEXAS TRUST LAW CHANGES (2003); COX, UPIA TWINS, 2004 Annual Advanced Estate Planning and Probate Course.

c. There is no "Absolute" Discretion.

Regardless of the language used in a trust instrument, a trustee's exercise of discretion in the performance of his duties is always subject to review by Texas courts under an "abuse of discretion" standard. Corpus Christi Bank and Trust v. Roberts, 597 S.W.2d 752, 754 (Tex. 1980).

d. Petitioning Court for Instructions.

A trustee may seek court clarification of ambiguous terms in the trust instrument or of issues relating to discretionary decisions (other than the trustee's power to adjust between principal and income, judicial control over which is now provided in §116.006). An action may be filed under the Declaratory Judgment Act, Tex. Civ. Prac. & Rem Code §§37.001 et seq. An action also may be filed under Texas Trust Code §115.001(a) to:

- (1) construe a trust instrument;
- (2) determine the law applicable to a trust instrument;
- (3) appoint or remove a trustee;
- (4) determine the powers, responsibilities, duties and liability of a trustee;
- (5) ascertain an officary;
- (6) make determinations of fact effecting the administration, distribution, or duration of a trust;
- (7) determine a question arising in the administration or distribution of a trust;
- (8) relieve 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;

- (9) require an accounting by a trustee; review trustee fees, and settle interim or final accounts; and
- (10) surcharge a trustee.

II. TRUST MANAGEMENT AND INVESTMENTS - THE PRUDENT INVESTOR STANDARD

A. Texas Trust Code Chapter 117 - Uniform Prudent Investor Act (UPIA)

1. APPLICATION OF UPIA

Effective January 1, 2004, Texas adopted the Uniform Prudent Investor Act (“UPIA”), which is contained in Chapter 117 of the Texas Trust Code. Section 117.003 of the Texas Trust Code provides that a trustee owes a duty to the beneficiaries of the trust to comply with the “prudent investor rule.” The prudent investor rule is a default rule, but it may be expanded, restricted, eliminated or otherwise altered by the provisions of a trust. A trustee is not liable to a beneficiary if the trustee acted in reasonable reliance on the provisions of a trust.

2. STANDARD OF CARE

Under the prudent investor rule, a trustee must 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. 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. The following eight specific circumstances are listed for the trustee’s consideration in making investment and management decisions:

- a. General economic conditions;
- b. The possible effect of inflation or deflation;
- c. The expected tax consequences of investment decisions or strategy;
- d. The role that each investment plays within the overall trust portfolio;
- e. The expected total return from income and the appreciation of capital;
- f. Other resources of the beneficiary;
- g. Needs for liquidity, income and preservation or appreciation of capital; and
- h. An assets special relationship for special value, if any, to the trust or a beneficiary.

A trustee may invest in any kind of property or type of investment consistent with the standard of the UPIA. A trustee who has special skills or expertise has a duty to use those special skills or expertise.

3. DIVERSIFICATION

Section 117.005 of the Texas Trust Code mandates that a trustee diversify the investments. No guidance is provided regarding what is proper diversification. If the trustee “reasonably determines that, because of special circumstances, the purpose of the trust are better served without diversifying,” then the trustee is not

required to diversify. The Comments suggest some possible special circumstances could include tax considerations, ownership of a family business, and securities law issues.

4. DUTIES AT INCEPTION OF TRUSTEE-SHIP

Section 117.006 requires a trustee “within a reasonable time after accepting a trusteeship or receiving trust assets,” 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 [the UPIA].”

Former Section 113.003, which allowed a trustee to retain property constituting initial trust corpus without regard to diversification, has been repealed.

5. DUTY OF LOYALTY

Section 117.007 of the Texas Trust Code provides that a “trustee shall invest and manage the trust assets solely in the interest of the beneficiaries.”

6. DUTY OF IMPARTIALITY

“If a trust has two or more beneficiaries, the trustee shall act impartially in investing and managing the trust assets, taking into account any differing interests of the beneficiaries.” TEX. PROP. CODE §117.008.

7. DELEGATION OF INVESTMENT AND MANAGEMENT FUNCTIONS

Under prior law, a trustee was permitted to delegate investment and management functions, but the trustee remained primarily responsible for the activities of the trust. New §117.011 permits the trustee to avoid liability for the actions of the trustee’s agent if such duties are properly delegated.

a. Duties When Delegating

“A trustee may delegate investment and management functions that a prudent trustee of comparable skills could properly delegate under the circumstances.” TEX. PROP. CODE §117.011(a). The trustee must use “reasonable care, skill and caution in (1) selecting an agent; (2) establishing the scope and terms of the delegations, consistent with the purposes and terms of the trust; and (3) periodically reviewing the agent’s actions in order to monitor the agent’s performance and compliance with the terms of the delegation.”

b. Duty of Agent

An agent to the fiduciary assumes the statutory obligation to the trust to exercise reasonable care to comply with the terms of the delegation. TEX. PROP. CODE §117.011(b). Further, the agent submits to the jurisdiction of the courts of the State of Texas. TEX. PROP. CODE §117.011(d).

c. Avoidance of Liability

A trustee who delegates investment and management functions in accordance with §117.011(a), is not liable for the decisions or actions of the agent, provided that:

- (1) the agent is not an affiliate of the trustee, or
- (2) the agent does not have a binding arbitration clause in its agreement and the generally applicable statute of limitations under Texas law for any action against the agent is not shortened. TEX. PROP. CODE §117.011(c).

8. PRINCIPLES OF PRUDENCE

The RESTATEMENT, THIRD indicates that there are fundamental principles to prudent investing, including:

a. Diversification

Trustees have a duty to diversify the investments of the trust estate.

b. Risk/Return Analysis

Trustees "have a duty to analyze and make conscious decisions concerning the levels of risk appropriate to the purposes, distribution requirements, and other circumstances of the trust they administer."

c. Cost Avoidance

Trustees have a "duty to avoid fees, transaction costs and other expenses that are not justified by needs and realistic objectives of the trust's investment program."

d. Balancing

A Trustee has the duty (because of the duty of impartiality) to balance the elements of return between production of current income and protection of purchasing power.

e. Delegation

A Trustee may have a duty (as well as having the authority) to delegate some of his investment duties, as a prudent investor would.

III. EVALUATION OF TRUST ESTATE**A. Initial Evaluation**

Upon accepting a trust, the trustee must promptly review all trust investments. Although it may take a trustee a significant period of time to fully evaluate all assets and to dispose of assets that are not appropriate for the trust estate to retain, the trustee should perform an immediate review of the trust assets to spot potential problems and to take steps to begin dealing with the problems. In the case of a corporate trustee, the Comptroller of the Currency Regulations require a national bank trust department to "review all trust investments promptly after accepting its appointment and, thereafter, at least once a year." Comptroller of the Currency Regulation 12 C.F.R. Section 9.7(a)(2).

B. Review of Prior Trustee's Actions

Section 114.002 of the Texas Trust Code provides that a successor trustee is liable for a breach of trust by a predecessor trustee only if he "knows or should know of a situation constituting a breach of trust committed by a predecessor" and the successor permits the breach to continue, fails to make reasonable effort to compel the predecessor trustee to deliver trust property, or fails to make reasonable efforts to compel the predecessor trustee to redress a breach of trust. In trusts in which there have been conflicts between the beneficiary and the trustee (or other beneficiaries) or litigation with regard to a trust estate, the trustee may find it advisable to obtain a judicial settlement of the trust accounts. More frequently, this is an expense that seems excessive to impose on the trust estate. In those cases, the trustee may ask all of the beneficiaries to consent to not obtaining a judicial settlement of accounts, even if the trust instrument itself contains exculpatory clauses which authorize a trustee to accept a predecessor's accounts. If the former trustee is resigning, the beneficiaries should approve the resigning trustee's actions and relieve the successor trustee of any responsibility for reviewing the prior trustee's actions. The trustee should review the predecessor trustee's accounts in any event, and verify that there do not appear to be any improper transactions. A judge or jury may find that a successor trustee who fails to take any steps to review prior accountings, and the acts of the trustee as reflected on the accounts, "should have known" of the information or breaches of trust which were contained in those accounts.

C. Periodic Evaluation

The Trustee should review the trust estate on a periodic basis, but generally at least once a year. This includes reviewing the trust investments, performance, projected cash flow, distribution levels and needs of the beneficiaries. Regular and prudent review may protect the trustee from liability. A bank administering a trust which declined in value from \$940,000 to \$93,000 in a three year period was found not liable for the loss. The bank was protected by its extensive records, which showed the trust was reviewed on over 40 occasions during that period, and several meetings were held with the beneficiaries. Stark v. U.S. Trust Company of New York, 445 F.Supp 670 (S.D.N.Y., 1978).

D. Evaluation of Assets

The trustee should evaluate the entire trust corpus for asset diversification and allocation. The trustee should keep or bring the trust estate into conformity with the investment policy (discussed in Section V) determined by the trustee. The trustee should develop a plan for liquidation and shifting of assets among categories over a period of time, to effectively implement the trustee's investment policy.

IV. SPECIAL ISSUES WITH TRUST ASSETS**A. Real Estate****1. ENVIRONMENTAL RISK EVALUATION**

The trustee should take steps to evaluate and minimize any potential environmental risks associated with holding real estate. A full discussion of environmental risks and possible steps that can be taken to minimize that risk is beyond the scope of this article, but the trustee should take steps to identify any environmental exposure, minimize that exposure and set up procedures to avoid environmental problems arising in the future. Potential protective environmental actions include carefully selecting the tenants and managers responsible for maintaining property (including the financial ability of those persons to rectify any environmental problems created by them), performing environmental audits, and carefully drafting property management and lease agreements to deal with environmental issues. With regard to property that the settlor or another party desires to add to the trust, or which may be purchased by the trustee at a later date, the trustee should perform due diligence before accepting or purchasing the property, to insure that the trustee is not taking on environmental liabilities and thus exposing the remainder of the trust estate to liability. In some cases, taking these steps may also give the trustee a defense that will prevent the imposition of liability on the trustee or the trust estate, even if environmental contamination is later found to exist. An excellent discussion of a fiduciary's risks and possible defenses in the environmental area can be found in Environmental Liability, by Michael L. Graham and Philip M. Lindquist, Advanced Estate Planning and Probate Course, State Bar of Texas, 1992.

2. EVALUATION OF CASUALTY AND LIABILITY INSURANCE

The trustee should confirm that there is current and appropriate casualty and liability insurance for all real estate owned by the trust. Each policy should be read by the trustee in its entirety. Care should be taken to insure that each policy's coverage will be effective and adequate. Exclusions (such as vacant dwellings) that may apply should be carefully reviewed.

3. REVIEW OF LEASE TERMS AND THEIR COMPLIANCE

Each lease on each piece of real property owned by the trust should be read in its entirety. The trustee should make note of applicable notice provisions regarding the lease termination date and any notices that may need to be given or received. The books should be reviewed to confirm that the tenant is paying the proper amount (particularly in a net lease, where taxes or other expenses that are to be borne by the tenant may change). With respect to leases that are nearing their expiration, the trustee should evaluate whether

the lease is on market terms, and should begin taking steps to re-sign the tenant or to actively attempt to lease the property before it becomes vacant. Any improved real estate which is not leased should be carefully reviewed and appropriate steps should be taken to protect the property from vandalism or other damage, to lease the property, if possible, or to dispose of the property, if appropriate.

4. PERSONAL SITE EVALUATION

The trustee should schedule time shortly after taking over the trust to personally inspect any real property owned by the trust. For property located at a great distance from the trustee, the trustee may consider hiring an agent to make an inspection for him. If the property is very valuable (and thus the travel expense can be justified), the trustee should make the inspection personally. An inspection of the property can expose a number of potential problems, such as possible environmental or other hazards that may expose the trust estate to liability, the use of the property by unauthorized persons, lack of compliance by the tenants with lease requirements, maintenance needs, potential zoning changes, and possible changes in the area around the property which may affect the value and use of the property in the future.

5. REVIEW OF PROPERTY TAX APPRAISALS

Property tax appraisals from each taxing authority should be reviewed to insure that the value of the property is not overstated. The trustee should take steps to reduce any overstated values to appropriate levels. Even if the property is specially valued for agricultural purposes, the trustee should nonetheless make sure that the property tax appraisal reflects true value, rather than an overstated value. An overstated value will have an effect on roll-back taxes, if and when the property is sold. The trustee should also verify that the property taxes on the property are current, and that any appropriate exemptions or special use valuations available to the trust estate are being utilized.

B. Mineral Interests

1. REVIEW DIVISION ORDERS

All division orders should be reviewed to insure they properly reflect the trust ownership and that the trust is receiving the royalties and other payments to which it is entitled.

2. NOTIFY OPERATORS AND LESSEES OF TRUST INFORMATION AND ADDRESS

The operators, lessees and other parties who may be making payments as a result of mineral interests (as well as the appropriate taxing authorities) should be notified of the change of trustee and the trust address.

C. Business Interests

The presence of a business interest in a trust estate, whether originally contributed or purchased by the fiduciary, presents significant risks and issues for the trustee. An excellent article by Dennis I. Belcher entitled Management of Assets by a Fiduciary: Avoiding Surcharge Litigation, which was presented at the 14th Annual Advanced Estate Planning and Probate Course (1990), gives significant guidance to a trustee with regard to handling business assets in a manner designed to avoid fiduciary liability.

1. EVALUATION OF TYPE OF INTEREST HELD

The trustee should identify the type of business interest held, and the restrictions, voting rights, management rights and other characteristics of the interest held. The trustee should also determine whether the interest is marketable.

2. REVIEW BUY-SELL AGREEMENTS, BUSINESS CONTINUATION AGREEMENTS OR OTHER SHAREHOLDER AGREEMENTS

The trustee should request and review all buy-sell agreements, voting agreements, business continuation agreements and other shareholder agreements to which the trust is a party or which impose restrictions on, or give rights to, the business interests held by the trust. The trustee should make notation of the substantive provisions of the documents. Notice of the trustee's current address should be given to the other parties in the manner specified in those documents, to insure that the trustee in fact receives the notices required to be given to the trustee. In addition, it may be advisable to have those agreements reviewed by counsel to determine whether they are still appropriate to the current circumstances of the trust and if not, whether those documents can be re-negotiated. In connection with reviewing these agreements, the trustee should also review any insurance on owners or other key employees which is designed to fund payments under those agreements, and should verify that the insurance is in fact in place, is owned by the proper entity, and is payable to the proper beneficiary.

3. EVALUATION OF CONTINUATION OF BUSINESS VERSUS SALE OR WINDING DOWN OF INTEREST

In the context of an interest in a closely-held business of which the trust holds a controlling interest, the trustee's initial determination should be whether the business should be continued, liquidated or sold.

a. **Factors to be Considered in Making Determination**

In determining whether to sell or continue a business, the trustee should take into account the following factors:

- (1) Whether the trustee is authorized under the trust instrument to continue a business;

(Note: Section 113.008 of the Texas Trust Code authorizes a trustee to invest in, continue, or participate in the operation of any business or other investment enterprise in any form.)

- (2) Whether holding the business will allow the trust to be adequately diversified;
- (3) Whether sufficient funds are on hand to operate the business;
- (4) Whether there is a market (or a market can be created) for selling the business interest;
- (5) Whether the expected returns of the business are sufficient to offset the risks associated with the business;
- (6) Whether competent people are running the business, or can be hired to do so at an acceptable cost (a business which has generated a nice income for the founder of the business may not be of sufficient size to provide a reasonable return to the trust estate while also having to pay an outside person to run the business);
- (7) Other pertinent factors.

4. STRUCTURE OF BUSINESS

If the trustee decides to continue the business (whether indefinitely or for some winding up period), the current structure of the business should be evaluated and any appropriate changes in structure made. Possible types of entities to be used for business interests include a sole proprietorship, general partnership, limited partnership, limited liability company (in states recognizing those), and corporations (including S

corporations, assuming that the trust will qualify as a QSST under Section 1361 of the Internal Revenue Code of 1986). In making the determination of which entity should be used, the trustee should consider the cost associated with changing the current business structure, limiting the liability of other trust assets to exposure from the business risks, providing the fiduciary appropriate control of the business, minimizing negative income tax consequences, and limiting adverse effects to beneficiaries upon termination of the trust.

5. SUBCHAPTER S ("QSST") FILING REQUIREMENTS, IF NECESSARY

If a trust acquires stock in a corporation that will be treated as an S corporation for federal tax purposes, and if the trust is not a grantor type trust for income tax purposes, a QSST election must be made. This election must be filed within 75 days of the date the trust acquires the stock. See Regulations Section 1.1361(d). If the trust cannot qualify as a QSST, the trustee must make a prompt decision whether to dispose of the stock (by sale or distribution) in order to allow the corporation to continue as an S corporation, or to continue to hold the stock, thereby terminating the corporation's S status. Any agreements which may impose liability on a shareholder for terminating the corporation's S election should be carefully reviewed and evaluated.

Note: The trustee must be careful to act from proper motives if he is selling or distributing stock to preserve the S election. Any benefits to the trustee (i.e., if the trustee is also a shareholder in the business) from retaining S corporation treatment may subject the trustee's action to second-guessing by the beneficiaries and the courts.

D. Review Cash Accounts

1. INSURED ACCOUNTS

The trustee should determine whether all cash in bank accounts is within the insured limits in an FDIC insured institution. If not, the trustee should evaluate the strength of the financial entities in which the accounts are held and should take appropriate steps to protect the cash assets of the trust estate.

2. INTEREST BEARING ACCOUNTS

A trustee who fails to maintain all cash funds in interest-bearing accounts may be questioned by beneficiaries at a later date. If the trustee determines to hold any operating funds in non-interest bearing accounts, records should be kept which indicate the reason for this choice (i.e. monthly fees or other charges would exceed any possible interest earned). Daily "sweeping" of cash in brokerage accounts can be set up, so that as cash is earned or deposited, it is swept into an interest-bearing account.

3. EXCESS CASH

To the extent cash is not needed for the regular trust operations, the trustee should carefully evaluate alternatives to cash, such as short-term debt instruments, certificates of deposits, T-bills and other investment alternatives with high liquidity, minimal volatility and rates superior to those obtained in bank accounts or money markets.

E. Stocks and Bonds

The trustee should evaluate individual issues of stocks, bonds and mutual funds that may be held by the trust estate to determine whether these should be maintained as investments for the trust estate. Immediate attention should be given to any issues which are known to be "troubled" to determine whether it is prudent to retain those while implementing the investment policy, or whether prompt action is required to sell any such securities.

F. Life Insurance Policies

1. DUE DILIGENCE/INVESTIGATION OF COMPANY

The trustee should perform due diligence to determine whether the company providing the insurance is sound financially. There are four major rating agencies for life insurance companies, including A.M. Best Co., Standard & Poors, Moody's, and Weiss Research. A trustee would be well advised to maintain policies which have high ratings by at least three of the ratings firms. Before purchasing a new policy, the trustee should consider the impact of the "load" (the commissions payable) on the expected performance of the policy, and whether there are comparable policies available with a lower load.

2. APPROPRIATENESS OF INVESTMENT IN LIFE INSURANCE

The Trustee should evaluate whether the life insurance policy is an appropriate asset to hold in the trust. If insurance comprises the entire trust estate (such as with a traditional irrevocable life insurance trust), the trustee may be questioned about his failure to diversify the trust estate. Life insurance policies, over time, have not traditionally performed as strongly as a more traditional well-diversified portfolio. Nonetheless, life insurance may be an entirely appropriate investment to own, given the purposes of the trust. In fact, the grantor of a trust frequently intends the trust to be solely for the purpose of owning such policies, and does not intend, at least until the proceeds are paid, for the trustee to create a diversified trust estate. The trustee, however, is required to look at the overall trust estate (and not the overall estate plan or assets of the grantor) in determining the prudence of trust investments. Barring protective language in the trust instrument, the trustee should at a minimum obtain consent from the beneficiaries to invest solely in life insurance. Due to the repeal of Section 113.003 of the Texas Trust Code in 2004, retention of the policy as an original trust investment is not automatically protected. *See* TEX. PROP. CODE §117.006. Even if retention of the policy is permitted, the trustee is making an investment decision separate and apart from the original contribution to the trust estate when he uses future contributions to the trust estate to pay additional premiums on that policy, which could result in liability.

G. Notes

The Trustee should review all notes due and owing to the trust estate, including determining the current balance due and whether the payments are current or in default. The trustee should also review any security agreements or deeds of trust securing the payments under the note. If the note is in default, the trustee should take steps to get the maker to bring the note current. The trustee should take appropriate action on a note in default before the collection of the note is barred by the applicable statute of limitations. Note: If the note is secured by real estate, any environmental risk should be evaluated before the trustee forecloses upon the property.

V. DEVELOPING APPROPRIATE INVESTMENT POLICY

A. Setting the Investment Policy

1. FACTORS TO CONSIDER

An investment policy is a "blueprint" for trust investments and all investment decisions shall be made within the context of that "blueprint". The policy should assist the trustee in implementing, monitoring and evaluating the trust's investments. Although failure to follow an investment policy may well subject a fiduciary to liability if the fiduciary fails to document the reasons for the deviation, liability frequently arises because there is no clearly articulated investment policy. Without an investment policy in place, investment decisions are far too frequently made on an ad hoc basis, without adequate thought given to the investment in the context of the overall financial plan for the trust. Since a poor investment policy or an investment

policy which is not followed can be used against a trustee, the policy must be prudently developed and should be one that the trustee can and will follow.

2. INFORMATION TO BE RECEIVED BEFORE SETTING INVESTMENT POLICY

In setting an investment policy, the trustee should communicate with the beneficiaries regarding their projected needs for distributions (which will impact the amount of income or cash flow to be generated by the trust, as well as the amount of assets appropriate to hold in cash or similar investments for upcoming distributions), and the beneficiaries' (including remainder beneficiaries) tolerance for risk. The trustee should also consult with investment advisors or study investment philosophies and trends before developing the policy.

3. COMPONENTS OF INVESTMENT POLICY

a. **Performance Goals**

The trustee should set up a desired long-term rate of return on assets. This would typically be defined as some percentage above the rate of inflation (usually determined by the Consumer Price Index). The goal should be a rate which is achievable and reasonable in light of historical returns of well-diversified portfolios (i.e., 3% to 5% above inflation) and should not be set at a rate which will encourage speculative investment, as opposed to a plan of long-term investing for growth and income. For shorter term trusts and trusts which have to generate a certain amount of income to be able to satisfy obligations or distribution needs, the target rate of return may be adjusted downward as appropriate. In setting a performance goal for the trust, the trustee should look at historical long-term performance of various classes of assets. The trustee should be cautious about setting goals that reflect the 1980's rates of return, which may not be realistic in the future. The investment policy should also make note of when those goals may not be achievable. For example, most investment plans indicate that the goals may not be met during extended periods of high inflation.

b. **Asset Allocation**

Recent research indicates that the long-term performance of a portfolio is more dependent upon the asset allocation of the portfolio (i.e., how much of the portfolio is invested in each class of asset), rather than upon the performance of the individual assets which comprise the portfolio. That is, long-term performance is more influenced by the percentage of the fund devoted to equities versus fixed-income investments, than it is by the individual issues of stock which are owned by the trust. See, The Relative Importance of Asset Allocation, by Gary Brinson, Randolph Hood, and Gilbert Beebower, American Association of Individual Investors, October, 1987, which summarized a study of pension plan trust funds. The authors determined that 93.6% of the variation in performance between the pension plan trust funds studied was due to investment policy i.e. asset allocation, and only 6.4% to timing and individual security selection. Asset classes might, when prudent, include cash, fixed-income (including taxable and non-taxable bonds) securities, domestic equities (large companies), foreign equities, small or mid cap equities, real estate, oil and gas interests, and business or venture capital investments. All classes should be evaluated to determine if appropriate and prudent to hold in the trust estate. The trustee should select among the asset classes appropriate for investment by the trust, and should determine the percentage of the trust estate to be devoted to each asset class, based on the trust's investment time-frame, the risk tolerance of the beneficiaries, and the trust's overall performance goals. Some permissible variation among percentages of asset classes may be specified (i.e., domestic large company equities shall comprise 15% of the trust estate, plus or minus 5%). This allows the trustee to adjust percentage holdings when market conditions indicate this is appropriate, without changing the basic investment policy.

c. Guidelines for Investments

Part of the investment policy should be the establishment of appropriate guidelines for investments in the various asset classes. For example, for bonds the trustee may set minimum quality requirements set by the ratings agencies and maximum maturity periods that will be required for trust investment. Similar criteria should be developed for other asset classes. In addition, limitations on the percentage of the trust estate which can be invested in any one security (or any one industry) should be specified. Any deviations from guidelines, and the reasons for that deviation, should be carefully documented by the trustee.

d. Procedure for Evaluation of Investments on an On-going Basis

On a regular basis, the performance of the trust estate should be evaluated against the performance goals set for the trust estate. In doing so, the trustee should stay mindful of the fact that short-term performance may not be indicative of long-term performance. If the trustee adjusts asset allocations and investment approach based on short-term information, the long-term investment plan of the trust estate is likely to be jeopardized. Nonetheless, benchmarks should be used to determine whether the investments are performing well within their particular class. For example, if the equity portion of the portfolio is performing substantially below the S&P 500, the trust portfolio, and the equity manager, if any, should be reviewed, but not necessarily changed (a value-oriented equity manager may under-perform the market in some time-frames and out-perform it in others). If funds are invested with a money manager or a fund that is performing at levels significantly below other funds or money managers with similar philosophies and goals, the fund or money manager should be reevaluated. For small companies, performance can be compared to the New York Stock Exchange Small Capitalization Index, the Dimensional Fund Advisors Company Fund, or the Russell 2000. The Morgan Stanley EAFE Index can be used for foreign equity performance comparisons. Bond indexes are more varied, due to different maturities, backing and infrequency of trading. Nonetheless, Shearson/Lehman Brothers, Salomon Brothers Broad Bond Index or others may be used for fixed-income comparisons. Tax-Exempt bonds can be compared to the Bond Buyer Municipal Index. Donaghue's Money Market Index can be used for money market comparisons.

VI. IMPLEMENTING THE INVESTMENT POLICY**A. Investment Consultants, Advisors and Managers****1. ADVISABILITY OF HIRING**

The cost of hiring investment consultants, advisors, or money managers may be an unnecessary expense for a trustee of a small trust with limited assets to invest, or for the trustee with significant investment expertise. For trusts with substantial assets, however, unless the trustee is willing to spend significant amounts of time on the trust investments and has the expertise necessary to analyze the investments, the requirement of prudence may necessitate hiring persons or entities to assist with devising and implementing the investment policy. In fact, the RESTATEMENT, THIRD takes the position that in order to conform to the prudent-man standard, in some circumstances the trustee may be required to obtain professional investment advice or delegate investment authority as a prudent man would. See the RESTATEMENT, THIRD §227, at comment j.

2. COST OF PROFESSIONAL ADVICE

Careful attention should be paid to the cost associated with obtaining professional advice and/or money management. Wrap accounts and similar arrangements that layer several types of investment fees may generate fees of 3% or higher on the investment assets. The trustee should carefully consider whether the anticipated returns from using such an arrangement will be great enough to make up the expense differential as compared to other alternatives.

3. SELECTING THE ADVISOR

If the trustee determines that it is advisable to obtain professional advice in some form, the trustee should take steps to insure that the selection of the advisor is prudent. This would normally include obtaining a number of referrals to brokers, investment consultants, and/or money managers. It is advisable for the trustee to interview several of these to be certain that the trustee is selecting an advisor with a similar philosophy, who understands the parameters of the trust, and the needs and philosophy of the trustee. The trustee should review the advisor's performance data. The trustee should be cautious in selecting advisors who obtain their compensation by commissions on products sold, rather than those whose fees are based on hourly rates or percentage of assets under management. Although many provide quality investment advice, there are also a number of individuals and entities who offer "financial and investment services," when in fact they are merely salesmen or sales organizations for particular products.

4. ISSUE OF IMPERMISSIBLE DELEGATION

a. **Duty Not to Delegate**

Section 113.018 of the Texas Trust Code provides that a trustee "may employ attorneys, accountants, agents, and brokers reasonably necessary in the administration of the trust estate." A trustee cannot, however, hire agents or otherwise delegate authority to a third person to carry out the trustee's powers which require the exercise of discretion on the part of the trustee. King v. Tubb, 551 S.W.2d 436, ref. n.r.e. (Civ. App. 1977). The trustee is under a duty "not to delegate to others the administration of the trust or the performance of acts in the administration of the trust that the trustee ought personally to perform." SCOTT on Trusts, Section 171. SCOTT goes on to state that "this does not mean, of course, that the trustee must personally perform every act that may be necessary or proper in the execution of the trust."

b. **The Restatement View**

The RESTATEMENT, THIRD was revised in 1990 to reflect that it may be proper for a trustee to delegate. Section 171 of the RESTATEMENT, THIRD provides "a trustee has a duty personally to perform the responsibilities of the trusteeship except as a prudent person might delegate those responsibilities to others. In deciding whether, to whom and in what manner to delegate fiduciary authority in the administration of the trust, and thereafter in supervising agents, the trustee is under a duty to the beneficiaries to exercise fiduciary discretion and to act as a prudent person would act in similar circumstances."

c. **Ability of Texas Trustee to Delegate Investment Decisions**

Under Section 117.011 of the Texas Trust Code, a trustee may delegate investment and management functions that a prudent trustee of comparable skills could properly delegate under the circumstances. The trustee must exercise reasonable care, skill and caution in selecting an agent, establishing the scope and terms of the delegation, consistent with the purposes and terms of the trust, and regularly monitoring the agent's performance. If these requirements are met, the trustee is not liable to the beneficiaries for the decisions or actions of the agent provided (1) the agent is not an affiliate of the trustee or (2) under the delegation agreement does not require arbitration of disputes with the agent, and (3) the agreement does not purport to shorten any applicable statute of limitations. An agent owes a duty to the trust to exercise reasonable care to comply with the terms of the delegation, and by accepting the delegation, the agent submits to the jurisdiction of Texas courts.

B. Mutual Fund Investments

1. ADVANTAGES

One method of obtaining professional investment management at a reasonable cost may be through purchasing shares of mutual funds. It may not be cost-effective for trusts under \$250K (or \$500K, for many money managers) to utilize an individual money manager. Since mutual funds are managed by professional money managers, the purchaser of the fund shares gains the benefit of that expertise. In addition, the utilization of mutual funds provides one of the primary components of prudent investing, which is diversification. A trust estate which is too small to cost-efficiently diversify on its own (i.e., does not have enough funds to buy the number of stocks and other investments necessary to comprise a well-diversified portfolio) can nonetheless acquire a well-diversified portfolio by holding shares in a mutual fund or funds.

2. COST

A mutual fund with costs and 12b-1 expenses in excess of similar mutual funds must out-perform those funds in an amount sufficient to overcome those higher costs and expenses. A trustee should carefully evaluate funds with high expenses before purchasing those funds, and should give careful consideration to similar funds with lower costs. Similarly, a fund must out-perform other funds significantly if it has a front-end load (a sales charge) or back-end redemption cost. The impact that those costs will have on long-term performance should be carefully reviewed by the trustee before purchasing a "load" fund versus a "no-load" fund. In general, brokers (at least at full service brokerage firms) can only purchase funds which have loads. Therefore, the trustee needs to do independent research if the trustee is using a full service broker for the other investment purchases of the trust, and should make the investment in mutual funds directly with the fund, so that the trust estate has access to the no-load funds. Another alternative (which has the benefit of providing a consolidated statement reflecting all the mutual funds held by the trust) is for the trustee to purchase no-load funds through a discount broker such as Charles W. Schwab, which will purchase no-load mutual fund shares for a set dollar fee (and will purchase shares in certain families of funds for no fee). Since discount brokers do not provide investment advice, this will still require independent research by the trustee.

3. SELECTING THE FUNDS

In selecting a mutual fund, the trustee should evaluate the long-term performance (as well as the recent performance compared to other similar funds) of the fund in question. The trustee should also look at the volatility of the fund in question. An aggressive fund which stays fully invested at all times may perform very well over the long-term, but with greater fluctuations (and thus greater downside risk) over the shorter term. For a trust with a twenty-year time horizon, this fund may be an appropriate investment, but may not be an appropriate investment for a trust with a two to three year time horizon, when the trustee might be required to sell in a "down" market. A number of publications provide at least once yearly "report cards" or evaluations of mutual funds. These include Forbes Magazine, (which gives each fund a grade in both bull markets and bear markets), The Individual Investor's Guide to No-Load Mutual Funds by The American Association of Individual Investors, Money Magazine, and other investment and business journals. There are also investment newsletters which monitor and evaluate mutual funds (as well as stocks and bonds) on a frequent basis. The Hulbert Financial Digest by Mark Hulbert rates the performance of investment advisory newsletters.

4. TYPES AND NUMBER OF FUNDS

Although a mutual fund is diversified in terms of holding a number of individual securities, a mutual fund typically is not invested in all asset classes in which a trustee may find it appropriate to invest trust funds. Therefore, multiple mutual funds may be used. For example, the trust estate could be diversified among the following types of funds: a small cap mutual fund, a fund specializing in more mature (but still

growth oriented) companies, a fund specializing in foreign equities, a fund specializing in income-oriented equities (utilities, oil and gas companies, and other high yield companies) and a fund specializing in fixed-income investments (or possibly several different funds specializing in fixed-income securities, with different maturity ranges). Likewise, funds having managers with different philosophies can be utilized.

5. COMBINING FUNDS WITH INDIVIDUAL SECURITIES

Even if a trustee is purchasing individual securities for the trust estate, the trustee may want to use mutual funds for some of the asset classes. For example, even if the trustee is comfortable with his ability as a prudent investor to invest in domestic securities, the trustee may want to use mutual funds for the foreign equities portion or the small cap portion of the trust estate.

C. Index Funds Solution

Another possibility (and one that seems to be favored by the RESTATEMENT, THIRD), is for the trustee to purchase index funds that track major stock exchanges or public listings of publicly traded stock such as the S&P 500, the Wilshire 4500 (or Wilshire 5000), the Value Line Composite, the Shearson/Lehman Broad Bond Index, etc). This assures that the trustee will not "under perform" those indexes by more than the expenses of the fund in question. The Vanguard family of funds (a no-load family of funds with low expense ratios) offers at least six index funds. Other families of funds offer index funds as well. Once again, the trustee must take care to allocate the trust estate appropriately between the various fund types.

D. Regular Review of Portfolio and Performance

The trustee should set a procedure for periodic review of the portfolio and its performance. Comptroller of Currency Regulations 12 CFR §9.7(a)(2) require a national bank trust department to review all investments at least once a year. Non-corporate fiduciaries would be wise to follow the same guidelines (at a minimum). The size and complexity of the trust estate may determine the frequency of the review. Yearly or more frequent reviews can help spot small problems before they develop into major ones and will give the trustee the opportunity to readjust the portfolio as appropriate and in keeping with the investment policy. If a particular asset class has experienced significant appreciation as compared to the other asset classes, the trustee should use the periodic review as an opportunity to sell some of the investments within that asset class, to bring the portfolio asset classes back within the investment policy parameters. The investment policy itself should articulate how frequently the portfolio review and reallocation among assets will occur. Under-performing investments or money managers should also be reviewed and changed, if appropriate.

VII. DISTRIBUTION GUIDELINES AND POLICIES

A. Provisions of Trust Instrument

The importance of reading and re-reading the trust instrument with regard to distributions cannot be overstated. The trust agreement should be read when the trustee initially begins serving, and also at each yearly review of the trust. In addition, the trustee should review the distribution provisions of the trust at any time a distribution request is being evaluated. The trustee should not only review the portion of the trust which actually grants the distribution powers, but should also review the entire trust instrument for other statements and clauses which indicate the settlor's intent with regard to distributions and the relative priority or preference to be given to beneficiaries.

B. Discretionary Distributions

1. EXTENT OF DISCRETION GRANTED

The trustee should determine the extent of discretion and the limits on discretion granted to him under the terms of the trust document. Even if the trust instrument uses terms such as "absolute" or "uncontrolled" to describe the discretion granted to the trustee, this will not generally be held to give the trustee total and unqualified discretion. In general, however, a court will not substitute its judgment for that of a trustee, so long as the trustee is acting in good faith, from proper motives and within the bounds of reasonable judgment. Section 187, SCOTT and the RESTATEMENT.

2. MONTHLY OR PERIODIC DISTRIBUTIONS

If a trust is to provide for health, education, maintenance and support (or other purposes) for a beneficiary, the trustee, after receiving information from and consulting with the beneficiary, is likely to find it less cumbersome to set a monthly or quarterly allowance to be paid to the beneficiary, rather than paying the expenses of the beneficiary directly or only upon request. In setting the allowance, the trustee should consider the income of the beneficiary (and must consider the income, if required by the document), the beneficiary's monthly budget of expenses (and the reasonableness of the monthly budget) and proof of expenses. In addition, the trustee should evaluate whether the trust will be able to continue providing that level of support and maintenance for the beneficiary for as long as the trust is required to do so (i.e., for the beneficiary's lifetime) or whether making distributions at that level will require invasions into corpus which will ultimately deplete the trust's ability to provide for the support of the beneficiary. The trustee should document the facts and circumstances and the basis for its decision to make or not to make distributions at a certain level. Trusts which allow a trustee to look at a beneficiary's needs in light of his or her accustomed standard of living may give the trustee additional guidance. If the beneficiary's budget includes items that are reasonable support for that beneficiary in light of his or her accustomed standard of living (such as expensive vacations, clothing or club dues), the trustee should maintain records which reflect that these are similar to the expenses previously incurred by the beneficiary. The trustee should retain in its records the beneficiary's request for the periodic allowance, and the amount requested. Income tax returns of the beneficiary, proof of expenses, and budgets submitted by the beneficiary should also be retained in the file by the trustee. The periodic allowance should be reviewed periodically (at least annually) and, the actual expenses of the beneficiary over that time period should be confirmed. Updated information should be recorded in the file.

If a minor is a current beneficiary of the Trust, special consideration must be given to the parent's legal obligation to support the child. Under Texas Family Code §151.001, a parent of a minor child has the duty to provide the child with clothing, food, shelter, medical and dental care, and education. A parent who fails to discharge the duty of support is liable to anyone who provides necessaries to the minor child. Distributions from a trust of which a minor is the beneficiary that discharge a parent's support obligation primarily benefit the parent, rather than the child. Unless the trust instrument expressly provides otherwise, a minor beneficiary's support should be provided by the parents rather than the trust.

3. ADDITIONAL DISTRIBUTIONS

In addition to a periodic allowance or distribution amount, the beneficiary may make requests for additional discretionary distributions. All of these should be made by the beneficiary, in writing, and retained in the trustee's file. If a request is made orally, and time requirements are such that the beneficiary cannot deliver to the trustee a written request, the trustee should obtain confirmation of the beneficiary's request in writing from the beneficiary as soon as possible after the distribution is made. In addition, the trustee should keep records of the telephone conversation or conference at which the request was made.

4. COMMUNICATING DISTRIBUTION DECISIONS

Although the trustee's relationship with the beneficiary will be more comfortable (at least in the short term) if the trustee is able to grant all of the beneficiary's requests, this is not always be possible. For example, if a beneficiary, who is intended by the trust estate to be supported for lifetime, is requesting distributions at a level that will over time deplete the trust estate, or if one beneficiary is requesting distributions to the detriment of other beneficiaries also intended to be provided for by the trust estate, the trustee may well be required to reject one or more distribution requests. If the trustee does an adequate job of explaining to the beneficiary, from the outset, the purposes of the trust and the funds available in the trust to satisfy those purposes, the trustee can further explain to the beneficiary in a meaningful way the reasons that a requested distribution cannot be made. Unless the beneficiary is a minor, the beneficiary deserves (and ultimately will demand) to be treated as an adult. The trustee who is willing to spend the time and effort to insure that the beneficiary understands both the benefits of the trust and the constraints that the trustee is operating under, and is able to present those to the beneficiary in a non-condescending and non-arbitrary manner, will find the beneficiary to be more reasonable in the requests that the beneficiary makes, as well as in response to the trustee's denial of requests. A correlation between the level of communication and involvement of beneficiaries and their satisfaction level was found in a recent study of twenty-two full service banks and the satisfaction of their trust beneficiaries. Those beneficiaries who were "highly satisfied" noted that they "often tended not to agree with the decisions of the trust administrator. Nonetheless, they recognized the 'bind' he or she is in." See Beneficiaries Are Satisfied When Involvement is Generated, by Russ Alan Prince, Trusts and Estates, August, 1991. This is important to the trustee, since "highly-satisfied" beneficiaries are much less likely to institute legal action against a trustee.

5. RESPONSIVENESS

The trustee should have an internal policy on how quickly the trustee will respond to the distribution requests of a beneficiary. A beneficiary who waits several months to receive a response of any sort from the trustee with regard to a request will question whether the trustee is devoting the proper attention to the trust estate and the beneficiary's needs. This is especially true if the response is ultimately a negative one. Although major changes in distribution patterns or significant special distribution requests may require additional time in terms of obtaining the documentation necessary from the beneficiary, and evaluating the ability of the trust estate to satisfy that distribution request, the trustee should nonetheless promptly (certainly within ten days, unless the distribution request is of the nature that requires a more urgent response) discuss with the beneficiary the request, the additional information that will be needed and should set a time for a definite response to the request.

6. TAX IMPACT

The trustee should take into consideration the tax impact that distributions from a particular trust will have. For example, if trusts are created for children and grandchildren, some of which are grandfathered or otherwise exempt from generation-skipping taxes and others of which are not, the trustee should obviously strive to make distributions to the children's generation (as well as distributions to the grandchildren for tuition or medical expenses that will also be protected from those taxes), from the non-exempt trust while reserving the exempt trust (where possible) to the grandchildren and younger generation beneficiaries. Likewise, a trustee should generally make distributions to a surviving spouse from a marital trust that will be included in the spouse's estate, before making distributions to the spouse from a bypass or credit trust.

C. Proper Weighing of Beneficiaries Interests

The trustee of a trust which has more than one beneficiary, whether the beneficiaries are current beneficiaries or have successive interests in the trust, must attempt to properly weigh the interests of the various beneficiaries. Obviously, if the settlor has provided that one beneficiary should have priority (such as a surviving spouse) the trustee should take this into account and give priority to that beneficiary. In other

trusts, the trustee must consider the ability of the trust estate to provide for all of the beneficiaries and carefully weigh the distributions to beneficiaries in light of their various interests. The trustee should document and make notes on reasons for making or denying distributions to beneficiaries and should reflect the rationale for the decision. Courts will not "step into" the shoes of a trustee to alter or question a discretionary decision for the trustee in most cases. If there is no evidence that the trustee has in fact, however, considered the various issues appropriate to the decision, if the decision appears clearly arbitrary, or if the communications to the beneficiary are harsh or poorly thought-out, then a court is far more likely to substitute its judgment for the judgment of the trustee, and to find that the trustee acted improperly.

D. Loans to Beneficiaries

A trustee may consider loaning funds to a beneficiary for certain purposes instead of making a distribution for those purposes. In a multiple beneficiary or "pot" trust this is sometimes seen as a way to satisfy a beneficiary's needs, without giving one beneficiary "too much" of the trust estate. For a trust that will divide into shares at some date (i.e. a surviving spouse's death, or when the youngest child reaches a certain age), it is sometimes intended that the loan will simply be offset against the beneficiary's ultimate share. The trustee should be as cautious about making loans to beneficiaries as making distributions. Before loaning trust funds, the trustee should first determine if the trust document permits loans to beneficiaries. If permitted, the trustee should evaluate the security for the loan and the beneficiary's ability to repay the loan. Too often decisions to loan funds to beneficiaries in fact become decisions to make a distribution, because the beneficiary can't or won't repay the loan. The trustee who loans trust funds to a beneficiary must be prepared to deal with default, if it occurs. All loans should be properly evidenced by a note, with any appropriate security agreements executed as well.

VIII. ACCOUNTING

A. Duty to Prepare Accounts

1. TEXAS TRUST CODE

Section 113.151 of the Texas Trust Code states that a beneficiary has the right to demand a written statement of accounts covering the trust's transactions. If the trustee fails or refuses to provide an accounting, the beneficiary may go to court to compel the trustee to provide an accounting. Except in unusual circumstances, however, the trustee is not required to provide an accounting more frequently than once every 12 months. An "interested person" (described in Section 111.004(7) of the Texas Trust Code as any person having an interest or claim against the trust or any person who is affected by the trust's administration), can also file a suit to compel an accounting.

2. STATUTE OF LIMITATIONS

An action against a Trustee for breach of fiduciary duty and most other actions must be brought within four years after the day the cause of action accrues. TEX. CIV. PRAC. & REM. CODE ANN. §§16.004, 16.051 (Vernon 2002). The statute may not begin running until the facts constituting a cause of action are discovered, however. In addition, the statute may be tolled during a beneficiary's minority or disability. Thus it is important that the trustee retain all trust records from the time the trustee begins administering the trust (together with any accountings or records supplied by any predecessor trustee). In addition, it is important that the trustee's annual accountings contain enough detail about the transactions that have occurred to put the beneficiaries on notice of the trustee's acts. If a transaction has been fully disclosed in an accounting, the accounting may be used to bar claims made as a result of the transaction, if four years have elapsed.

3. CONTENTS OF ACCOUNTING

Section 113.152 provides that a written statement of accounts must show: (1) the trust property that has been received and was not previously listed in a prior accounting, (2) a list of receipts and disbursements, allocated between income and principal, (3) a list and description of all property being administered (with descriptions), (4) cash accounts, their balance, and where they are deposited, and (5) a list of all trust liabilities. In the interest of providing full disclosure to the beneficiary, it may be necessary to provide more than a "bare bones" accounting. First of all, the accounting should be in understandable form and should include any information necessary for the recipient of the accounting to get a complete picture of the trust administration during the time period covered. The detail required on an accounting and the amount of time required to prepare the accounting will depend on the nature of the trust assets and the activity (receipts of income, sales of assets, investments, payment of expenses and distributions to beneficiaries) of the trust.

4. ACCOUNTING FOR SMALLER TRUSTS

An accounting for a trust that has limited assets and few distributions can be quite simple, but it nevertheless should be prepared and distributed to beneficiaries on an annual basis. For a trust that holds its property in a money market account or in mutual funds, it may be sufficient to simply provide the beneficiary with the bank or mutual fund statements. If the bank or mutual fund sends out a yearly summary, this can be used. Otherwise, each month's account statements should be collected and sent. If expenses have been paid out or distributions have been made, copies of checks should be included, with sufficient notation in the memorandum section of the check to fully describe the purpose of the expenditure or distribution. For simple trusts with more than one asset, the trustee may want to use a statement of accounts that is more detailed but can be prepared on a one or two page form. If multiple mutual funds are to be held, for ease in record-keeping, the trustee may want to buy these through a discount broker such as Charles Schwab, which will purchase no-load funds for a small cost (or at no cost for some families of funds), so that all accounts will be consolidated on one statement. If few transactions are involved, a simple handwritten or typewritten summary can be prepared.

5. MORE COMPLEX TRUSTS

For trusts that have a number of properties, or trusts that are engaging in many transactions during the year, the trustee must have a system that is adequate to properly record and reflect these transactions. The trustee may consider hiring an accountant to prepare annual accounts in these circumstances. Alternatively, (or in addition) the trustee may utilize a computer program which is adequate to prepare the accounting. Even when an accountant is used to provide tax advice for the trust estate or to prepare the final accounting reports and tax returns for the trust, the trustee would be well advised, in a trust with numerous transactions, to utilize a computerized accounting package to keep a record of all of the transactions. These can be delivered to the accountant. There are various computer programs that a trustee could use to perform its accounting functions.

B. Frequency and Distribution of Reports**1. ANNUAL OR MORE FREQUENT REPORTING**

Reports should be prepared at least annually. Even if the beneficiaries do not request yearly accountings, the trustee should prepare the accounting each year as a matter of course. For larger trust estates, with many transactions, quarterly reports may be advisable.

2. DISTRIBUTION OF REPORTS

For any minor or incapacitated beneficiary, the report should be delivered to the parent, guardian or person having custody of the minor or incapacitated individual. The trust instrument should be reviewed for

report requirements and the trustee should comply with any specific provisions regarding the timing and distribution of reports.

C. Audited Financials

In most trust estates, the annual accountings will not be audited. For a large trust estate, however, or for a trust estate which has litigious beneficiaries, the trustee may determine that the expense of providing the beneficiaries with audited financials is justified.

D. Summary of Important Trust Transactions and Projections

When the accountings are distributed and sent to the beneficiaries, the trustee should include a written summary. If significant transactions (i.e. sales of major assets, significant changes in the trust estate, significant changes in value, etc.) occurred during the trust year, the trustee should give details on those. The summary should also include information regarding the performance of the trust over the past year. The trustee may also want to include information about the trust performance over a longer period of time. The trustee should also summarize any actions that are intended to be taken over the course of the year. For example, if the trust is selling or plans to sell a major asset or make a major investment, this should be noted in the summary. If the trustee is still in the process of implementing the investment policy, the trustee should inform the beneficiaries of the additional investments and sales which are likely to be made during the course of the year to implement the policy.

IX. RECORD KEEPING**A. Tickler Calendar for Important Dates**

A trustee must keep track of recurring events which require action. These would include, among other things, due dates of payments that must be made by the trust, tax returns or filings that must be made, mandatory distribution dates and termination dates. In addition to monthly, quarterly or annual reminders, the trustee should set up reminders for events to occur in future years. If the trustee does not have a reliable system to provide reminders in future years, notation of the anniversary date of those events may be made on the current year (e.g. on a calendar note "10 years until trust terminates", then on the next year's calendar, note "9 years until trust terminates").

B. Receipts, Bank Statements and Cancelled Checks

It is imperative that the trustee save all receipts (or billing statements, with the check to be used as a receipt), bank statements and cancelled checks. The trustee should use a checking account or money market account that returns cancelled checks for record-keeping purposes. Cancelled checks may contain useful information (especially if the trustee makes a habit of using the memorandum portion of the check), as well as acting as proof of payment. In general, the beneficiary is entitled to inspect the trust bank accounts and "vouchers". In order to be able to satisfy inspection rights of the beneficiary, and to prove that amounts paid were properly paid, the trustee should retain all receipts, copies of bills paid and other documents which will establish the purpose and propriety of the payment. Retaining all of those documents may also "save" a trustee that has been remiss in the duties of preparing annual accounts. A trust accounting can generally be reconstructed (although sometimes at considerable cost) if all bills, bank statements, deposits slips checks and other records are retained.

C. Written Broker's or Advisor's Reports and Recommendations

Reports and recommendations of brokers and investment advisors should also be retained, since they will help document the trustee's prudence in buying or selling an investment.

D. Written Correspondence To and From Beneficiaries and Telephone Memoranda

The trustee should retain a written record of all communication with the beneficiaries. A written record of all communications serves two valuable purposes. First of all, it helps the trustee reconstruct a history of the trust and provides additional information that may not be immediately reflected from the accountings and other financial documents for the estate. In reviewing the actions that were taken and the reasons for those actions, the records of these communications can be used to help refresh the memory of the trustee and help establish the trustee's "prudence." In addition, the natural tendency of a beneficiary who becomes unhappy with a trustee is to develop a somewhat "selective" memory. Retaining written documentation of all communications can assist with refreshing the beneficiary's memory, as well. The trustee should make sure, however, that his communications are ones that will not haunt the trustee. Hostile, arbitrary or poorly thought-out communications can and will be used against the trustee.

X. TAX REPORTING REQUIREMENTS

In addition to reporting to the beneficiary, the trustee has a duty to file tax returns with the Internal Revenue Service. Internal Revenue Code §6012(b)(4).

A. 1041ES

A 1041ES is used to make estimated payments for the trust, and must be filed when the trust is required to make estimated tax payments. A trust is required to make estimated tax payments when it: expects to owe \$500.00 or more of tax (after subtracting withholding and credits) for the year AND expects its withholding and credits to be less than the lesser of: 90% of the current years tax or 100% of the prior years tax (within certain limitations). An accountant should be consulted regarding the need for filing form 1041ES.

B. 1041**1. FILING REQUIREMENTS FOR TRUSTS**

IRC §6012(a)(4) requires a trust with \$600 or more of gross income, or any taxable income, to file a Form 1041 (a fiduciary income tax return).

2. EXCEPTIONS TO FILING REQUIREMENTS

Certain grantor-type trusts are not required to file a Form 1041. Generally, a trust is a grantor-type trust if the grantor has the power to control the enjoyment of trust income, or is otherwise treated as the owner of the trust under Internal Revenue Code Sections 671-678. Treasury Regulations §1.671-4(b) sets forth the types of grantor trusts that will not be required to file a Form 1041:

- a. Grantor is trustee (or co-trustee) of the trust and grantor (or a nonadverse party) has the power to return the trust property to grantor (such as by revoking the trust).
- b. If grantor and grantor's spouse are the sole grantors, at least one is a trustee and at least one (or a nonadverse party) has the power to return the trust property to the grantor or grantor's spouse (such as by revoking the trust).
- c. If a grantor-type trust does not come within the categories described above, a Form 1041 for each year showing the income, deductions, and credits of the trust must be filed. Form 1041 should be completed and a schedule of the trust's income to the grantor's individual income tax return - Form 1040.

C. Notice of Fiduciary Relationship - Form 56

This form is used by the trustee to notify the Internal Revenue Service of the creation, change, or termination of a fiduciary relationship. This form should be filed upon the creation, termination, or change of a fiduciary relationship. This ensures that the IRS will have the proper information on file and that the trustee will receive the notices sent by the IRS (or at least will have a defense if the notice is sent improperly). The form should be filed at the Internal Revenue Service Center where the trust files its tax return.

D. Taxpayer Identification Number

Form SS-4 is used to obtain a taxpayer identification number for a trust. Any trust that is required to file a tax return must have a taxpayer identification number. Currently the IRS will issue the identification number on-line at www.IRS.gov.

E. Generation-Skipping Distributions Form 706 GS(D-1)

If distributions are made to a "skip person," as defined in Section 2613 of the Internal Revenue Code of 1986, the trustee must report the distribution on Form 706GS(D-1), Notification of Distribution from a Generation-Skipping Trust. This must be filed with the Internal Revenue Service (with Copy B to the distributee) by the 15th day of the 4th month of the year following the calendar year of the distribution.

F. Generation-Skipping Transfer Tax Return for Terminations - Form 706GS(T)

The trustee must calculate and report the tax due from a trust termination subject to the generation-skipping tax on Form 706GS(T) by the 15th day of the 4th month following the year in which the termination occurs.

XI. SELF DEALING AND OTHER CONFLICTS OF INTEREST**A. Texas Trust Code Provisions****1. LOANS**

Section 113.052 of the Texas Trust Code prohibits a trustee from loaning trust funds to the trustee, to an affiliate, director, officer or employer of the trustee or an affiliate; to a relative of the trustee or to the trustee's employer, employee, partner or other business associate of the trustee. If the trustee is also a beneficiary, loans may be made to the trustee/beneficiary only if permitted by the trust instrument.

2. PURCHASES OR SALES

Section 113.053 of the Texas Trust Code prohibits the trustee from selling trust property to or purchasing trust property from, the persons listed in XIA1 above. A trustee may, however, comply with the terms of a written contract signed by the settlor.

3. SALE OF TRUST ASSETS TO ANOTHER TRUST

Section 113.054 of the Texas Trust Code prohibits a trustee from selling assets from one trust to another trust of which the trustee is also a trustee, unless the assets are bonds, notes, bills or other obligations fully guaranteed by the United States and sold for fair market value.

4. ADDITIONAL RESTRICTIONS

Additional restrictions on corporate trustees are covered in Sections 113.055 (purchase of trustee's securities), 113.056 (investment in bank-managed funds) and 113.057 (deposits with corporate trustee) of the Texas Trust Code.

B. Federal Provisions

For national bank trust departments, Comptroller of Currency Regulations prohibit similar transactions. Also prohibited, however, is self-dealing with individuals or organizations that have a relationship with the trustee that may affect the exercise of the best judgment of the trustee in the interest of the beneficiaries. 12 C.F.R. 9.12. An individual trustee should act as though these restrictions apply to the individual trustee as well, as they may be imposed by common law. See, Risser, discussed in Section C below.

C. Trust Instrument Provisions Authorizing Self-Dealing

Following the Texas Supreme Court decision in Texas Commerce Bank, N.A. v. Grizzle, 96 S.W.3d 240 (Tex. 2002), the legislature amended Section 114.007 of the Trust Code to prohibit the enforcement of an exculpation clause that would relieve a trustee of liability for a breach of trust committed in bad faith, intentionally or with reckless indifference to the interest of the beneficiary. A trust instrument also may not relieve the trustee for liability for any profit derived by the trustee from a breach of trust.

D. Some Common-Sense Advice to the Trustee

1. If you have to ask if it creates conflict of interest, don't do it.
2. If you will get a benefit (or if someone could think you will get a benefit) you would not get if you weren't trustee, don't do it.
3. If you'd rather not fully disclose it in advance to all beneficiaries, don't do it.
4. If a beneficiary objects, and a potential conflict exists, don't do it.
5. Poor judgment is sometimes forgiven by a judge or jury. Self-interest never is.

XII. RIGHTS AND LIABILITIES TO THIRD PARTIES**A. Torts**

Subject to the rights of exoneration and reimbursement, a trustee is personally liable for a tort committed by the trustee or the trustee's agents or employees in the course of employment. See Section 114.083 of the Texas Trust Code. In general, the trustee can obtain exoneration on reimbursement from the trust estate if: the trustee was properly engaged in a business activity and the tort one that is common in that business activity; the trustee is properly engaged in a business activity and neither the trustee nor an officer or employee of the trustee is guilty of actionable negligence or intentional misconduct; or the tort increases the value of the trust property. If, however, the trustee is entitled to exoneration or reimbursement because of an increase in value to the trust property, the amount of the exoneration or reimbursement is limited to the increased value of the trust property. See also Section 114.062 of the Texas Trust Code.

B. Contracts of the Trustee

If a trustee makes a contract in his capacity as the trustee of the trust, and a cause of action arises on the contract, the plaintiff may sue the trustee in his representative capacity and may collect the judgment against the trust estate. In addition, the trustee may be sued individually, if the contract does not exclude the trustee's personal liability. See Section 114.084 of the Texas Trust Code. That same section of the Texas Trust Code does, however, provide that use of the word "trustee" or "as trustee" after the signature of the trustee is prima facie evidence of intent to exclude the trustee from personally liability.

XIII. SUMMARY

The assets of a trust estate, and the circumstances of the beneficiaries, are not static. As a result, the decisions that a trustee is required to make, and the duties imposed upon the trustee, are constantly changing. Nonetheless, a trustee will avoid most of the problems which result in the trustee being sued or having confrontational relationships with beneficiaries, if the trustee: (1) views himself as responsible to all of the beneficiaries, and to the terms of the trust, (2) is able to "step into" the beneficiary's shoes and at least view things from the beneficiary's perspective (even if he does not ultimately agree with it), (3) devotes the time, energy and expertise necessary for the trust estate in question, (4) handles (even if the trust contains exculpatory clauses) the trust estate not only as he would want a trust estate handled for himself, but also as a prudent person would and (5) sets appropriate policies and procedures. If the trustee has not set up adequate procedures and policies with regard to the trust estate, however, or has not followed the policies and procedures that are in place, the trustee is likely to find that he is in effect personally guaranteeing the success of the decisions made. A trustee who is unwilling to take the steps outlined above would be well-advised to decline to accept the trusteeship, or to resign as trustee.

APPENDIX 1
INTERVIEW QUESTIONNAIRE (FOR SELECTING INVESTMENT ADVISOR)

	<u>Yes</u>	<u>No</u>
I. Advice includes:	_____	_____
A. A review of trust and beneficiary investment goals	_____	_____
B. Advice regarding:	_____	_____
1. Management/Budgeting/Accounting	_____	_____
2. Investment review/planning	_____	_____
3. Asset allocation	_____	_____
4. Liquidity needs/cash flow projections	_____	_____
5. Tax planned investments	_____	_____
6. Other:	_____	_____
II. Provide written analysis of trust financial status and recommendations for meeting specific needs of trust estate and beneficiaries?	_____	_____
III. Does advice include recommendation for specific investments?	_____	_____
Does advice include implementation assistance in purchasing investments?	_____	_____
IV. Monitor on-going investments and provide advice and suggestions when situation warrants change?	_____	_____
V. Take possession of or have access to trust assets?	_____	_____
Optional?	_____	_____
Mandatory?	_____	_____
VI. Compensation based on:	_____	_____
Fee only	_____	_____
Hourly rate \$	_____	_____
Flat Fee or %	_____	_____
Commission Only	_____	_____
Fee and Commission	_____	_____
Note: Trustee may want to determine from what source bulk of advisor's commissions are derived and whether advisor has interest in investment	_____	_____
Fee offset (commissions are offset against flat fee)	_____	_____
VII. Investment Advice regarding:	_____	_____
Real Estate Investments	_____	_____
Securities - Equities	_____	_____

	<u>Yes</u>	<u>No</u>
Bonds	_____	_____
Mutual Funds	_____	_____
Insurance Load No-Load	_____	_____
Cash Management	_____	_____
Oil and Gas Investments	_____	_____
Other: _____		

_____	_____	_____
Attach copy of Advisor's resume, showing education and experience.	_____	_____

APPENDIX 2
TRUST DISCRETIONARY DISTRIBUTION REQUEST FORM

Beneficiary: _____ Trust Name: _____

Date: _____ Trustee: _____

Request: (Amount requested, and purpose of the distribution)

Date Distribution Needed: _____

Anticipated additional distribution requests in next 12 months: _____

Attach all relevant information, copies of estimates, or expense statements, if applicable.

Signature of Beneficiary: _____

APPENDIX 3
DISCRETIONARY DISTRIBUTION CHECKLIST

Date of request _____

Beneficiary _____ Trust Name _____

Trustee _____

Is this a request for discretionary distribution _____ or loan _____

Funds needed for _____

Date needed _____

Total amount requested _____

From income _____ Principal _____

How will income generated be affected by this payment, if principal distribution made?

What other trust accounts, or outside funds, does the beneficiary have which could be used instead of those requested? _____

List any other potential beneficiaries of this trust and their interest: _____

Distributions to this beneficiary in prior 12 months: _____

Distributions to all beneficiaries in prior 12 months: _____

Income: Attach list

Principal: Attach list

Review income and principal provisions: and attach copy of language _____

What are the income tax consequences of this distribution, if authorized? _____

What are the estate tax or generation-skipping tax consequences of this distribution, if any? _____

Attach Distribution Request and copies of all relevant information.

Distribution approved: _____ Rejected: _____

Date: _____

Signature of Trustee: _____

APPENDIX 4
AUTHORIZATION FORM FOR LOAN FROM TRUST

Date Requested: _____

Name of Beneficiary Requesting Loan: _____

Purpose of Loan: _____

Date Loan Needed: _____

Financial Status of Beneficiary: Attach copy of most recent financial statement.

Terms of Loan: _____

Principal Amount of Loan: _____

% Interest _____ Collateral: _____

Due Date: _____

List Other Outstanding Financial Obligations: _____

Trust provisions allowing loan: _____

(attach copy of loan)

Loan Granted: _____

Loan Rejected: _____

Signature of Trustee

Date

APPENDIX 5
SIMPLE TRUST ACCOUNTING

1.	Assets Comprising Trust Corpus at beginning of Accounting Period (list)		
	Total Assets		\$ _____
2.	Liabilities of Trust Corpus at beginning of Accounting Period (list)		
	Total Liabilities		\$ _____
3.	Total Receipts During Accounting Period (list)		
	Income Receipts	\$ _____	
	Principal Receipts	\$ _____	
	Total Receipts		\$ _____
4.	Total Disbursements During Accounting Period		
	Disbursements chargeable to income	\$ _____	
	Principal Disbursement	\$ _____	
	Total Disbursements		<\$ _____ >
5.	Reconciliation		
	Total Starting Assets		\$ _____
	Total Starting Liabilities		\$ _____
	Total Receipts During Period		\$ _____
	Total Disbursements During Period		<\$ _____ >
	Total Trust Corpus at end of Accounting Period		\$ _____

APPENDIX 6
TRUST ESTATE EVALUATION CHECKLIST

Completion
Date

- I. Real Estate
 - A. Determine necessity of obtaining environmental risk evaluation.
 - B. Evaluate casualty and liability insurance on property.
 - C. If any real estate is leased, review lease terms and tenants compliance with lease terms.
 - D. Personally inspect property.
 - E. Review property tax appraisals for each property. Take steps to reduce overstated values, insure that property taxes are paid current, obtain appropriate exemptions.
- II. Mineral Interests
- III. Review division orders to insure that trust is reflected as owner.
 - A. Notify operators and lessees of name and address of trustee.
- IV. Business Interests
 - A. Evaluate viability of business.
 - B. Evaluate business structure. Are changes necessary?
 - C. Subchapter S filing requirements, if applicable.
 - D. Review buy-sell agreements associated with business as well as business continuation agreements and/or shareholder agreements.
- V. Cash Accounts
 - A. Determine if cash in banks is adequately insured.
 - B. Insure all funds maintained in interest bearing accounts. Utilize sweep accounts where appropriate.
 - C. Evaluate alternatives to cash.
- VI. Stocks and Bonds

Evaluate individual stocks and bonds.
- VII. Life Insurance
 - A. Investigate company.
 - B. Determine appropriateness of life insurance as trust investment.
 - C. Determine if beneficiary correctly designated.
- VIII. Notes

Insure payments are current, or if in default, determine appropriate action.

IX. Portfolio Review

- A. Review investment policy.
- B. Review asset allocation of trust
- C. Evaluate performance of assets, advisors and money managers.

APPENDIX 7
SALE OF SIGNIFICANT ASSETS CHECKLIST

- I. Beneficiaries Informed
- II. Appraisal Obtained
- III. Sales Price and Terms

* Attach records relating to marketing efforts, offers received.