



Trust Issues In Divorce Proceedings

David F. Johnson

DISCLAIMERS

- These materials should not be considered as, or as a substitute for, legal advice, and they are not intended to nor do they create an attorney-client relationship.
- Since the materials included here are general, they may not apply to your individual legal or factual circumstances.
- You should not take (or refrain from taking) any action based on the information you obtain from these materials without first obtaining professional counsel.
- The views expressed in this presentation do not necessarily reflect those of the firm, its lawyers, or clients.

Speaker

- David F. Johnson
- Trust/Estate/Closely Held Business Litigator
- Managing Shareholder, Fort Worth Office
Winstead PC
- 817.420.8223
dfjohnson@winstead.com
- www.winstead.com



Introduction

- Trust issues often arise in divorce proceedings.
- The author reviews and reports on new cases regularly at his blog: Fiduciary Litigator (www.fiduciarylitigator.com)
- “The Intersection of Texas Courts and The Fiduciary Field.”
- You can sign up for email alerts!

Introduction

- This presentation will address:
 - Fraud claims arising from the creation of the trust,
 - Conflict of interest issues arising from drafting of estate documents for a married couple,
 - Characterization of distributions from trusts,
 - Settlor/standing issues for trust disputes, and
 - Spouses as beneficiaries of trusts.

Basics



Basics

- A trust is a legal relationship in which the owner of property gives it to another person or entity who must keep and use it solely for another's benefit.
- In English common law, the party who entrusts the property is known as the "settlor," the party to whom the property is entrusted is known as the "trustee," the party for whose benefit the property is entrusted is known as the "beneficiary," and the entrusted property itself is known as the "corpus" or "trust property."

Basics

- A trust may be created by:
 - (1) a property owner's declaration that the owner holds the property as trustee for another person;
 - (2) a property owner's inter vivos transfer of the property to another person as trustee for the transferor or a third person;
 - (3) a property owner's testamentary transfer to another person as trustee for a third person;
 - (4) an appointment under a power of appointment to another person as trustee for the donee of the power or for a third person; or
 - (5) a promise to another person whose rights under the promise are to be held in trust for a third person.
- Tex. Prop. Code 112.001.

Basics

- No particular form of words is required to create a trust; however, to create a trust a document must be reasonably certain as to the putative trust's property, its object, and the beneficiary.
- A court looks to the settlor's intent to determine whether a trust was created. See Tex. Prop. Code Ann. § 112.002 ("A trust is created only if the settlor manifests an intention to create a trust.").
- “‘Property’ means any type of property, whether real, tangible or intangible, legal, or equitable, including property held in any digital or electronic medium. The term also includes choses in action, claims, and contract rights, including a contractual right to receive death benefits as designated beneficiary under a policy of insurance, contract, employees’ trust, retirement account, or other arrangement.” Tex. Prop. Code § 111.004(12).

Basics

- A married couple can create an enforceable trust where they are both settlors.
- The trust can be revocable or irrevocable.
- Spouses can donate community property to the trust and each other's separate property.
- Absent a fraud claim, an irrevocable trust will be enforceable and its assets will not be subject to division in the divorce.

Fraud



Fraud

- Spouses who are co-settlors and who fund a trust with community property or with their separate property often allege in a subsequent divorce that the trust should be unenforceable or rescinded due to fraud.
- It is clear that a trust created for a fraudulent purpose will not be enforced. *Rogers v. Rogers*, 240 S.W. 1104, 1105 (Tex. Comm'n App. 1922, judgm't. adopted).

Fraud

- To succeed on an actual fraud claim a plaintiff must present evidence that (1) the defendant made a material representation that was false, (2) the defendant knew it was false or recklessly made the representation, (3) the defendant intended the plaintiff to rely on the representation, (4) the plaintiff relied on the representation, and (5) the plaintiff was injured as a result. *See JPMorgan Chase Bank, N.A. v. Orca Assets G.P. L.L.C.*, 546 S.W.3d 648, 653 (Tex. 2018).
- "Constructive fraud is the breach of a legal or equitable duty which the law declares fraudulent because it violates a fiduciary relationship." *Carnes v. Meador*, 533 S.W.2d 365, 370 (Tex. Civ. App.—Dallas 1975, writ ref'd n.r.e.). Constructive fraud does not require the intent to defraud; instead it is an equitable doctrine employed by courts to rectify an injury resulting from the breach of a fiduciary relationship. *Carnes*, 533 S.W.2d at 372.

Fraud

- Because of the close fiduciary nature of the marital relationship, there is a continuing obligation of full disclosure as to the kind and character of assets involved and the reasonably foreseeable consequences the transactions will have on the rights of each spouse.
- Courts have invalidated interspousal transactions, such as trusts, entered in violation of this obligation.
- In *Dudley v. Lawler*, a court reversed a summary judgment for a defendant/husband regarding the funding of a family trust. 468 S.W.2d 160, 163 (Tex. Civ. App.—Waco 1971, no writ).
- The court held that the husband's representations as to nature and extent of community estate, if false, should be treated as fraud, justifying claims to void the transfer of property to the trust.
- Trustees are necessary parties to an action concerning a trust.

Conflict of Interest



Conflict of Interest

- Often a married couple will use the same attorney to do estate planning work.
- The attorney may recommend creating an irrevocable trust and placing community or separate property into the trust, thereby taking the property away from one or both spouses.
- Then the attorney drafts the documents to have one spouse or a friend of the spouse be trustee.
- The attorney may do other planning activities that may harm one spouse if the couple ever divorces.

Conflict of Interest

- Texas Rule of Disciplinary Conduct 1.06 states:
 - [E]xcept to the extent permitted by paragraph (c), a lawyer shall not represent a person if the representation of that person: (1) involves a substantially related matter in which that person's interests are materially and directly adverse to the interests of another client of the lawyer or the lawyers firm; or (2) reasonably appears to be or become adversely limited by the lawyers or law firm's responsibilities to another client or to a third person or by the lawyers or law firm's own interests.

Conflict of Interest

- (c) A lawyer may represent a client in the circumstances described in (b) if: (1) the lawyer reasonably believes the representation of each client will not be materially affected; and (2) each affected or potentially affected client consents to such representation after full disclosure of the existence, nature, implications, and possible adverse consequences of the common representation and the advantages involved, if any.
- Attorneys need extensive disclosures and waivers to do this type of work.

Conflict of Interest

- A violation of a disciplinary rule does not give rise to a private cause of action or create any presumption that a legal duty to a client has been breached. See *Adams v. Reagan*, 791 S.W.2d 284, 291 (Tex. App.—Fort Worth 1990, no writ).
- A plaintiff must look to common law breach of fiduciary duty claims.
- "Legal malpractice claims sound in tort." *Belt v. Oppenheimer, Blend, Harrison & Tate, Inc.*, 192 S.W.3d 780, 783 (Tex. 2006).
- "The plaintiff must demonstrate 'that (1) the attorney owed the plaintiff a duty, (2) the attorney breached that duty, (3) the breach proximately caused the plaintiff's injuries, and (4) damages occurred.'" *Id.*

Conflict of Interest

- An attorney has a strict of loyalty to solely look out for a client's interest above every one else's interests and the attorney's interests.
- An attorney has a duty of candor.
- Further, an attorney owes a duty to maintain the confidentiality of privileged communications received during the existence of the attorney-client relationship even after the termination of that relationship.
- These duties are difficult to comply with when the attorney represents joint clients in a trust transaction where their interests may conflict currently or in the future.

Standing

Standing To Sue

- **Allegations**
 - **Involves a Case/Controversy**
(refer: *Lujan v. Defenders of Wildlife*, 504 U.S. 555 (1992))
 - **Plaintiff Has Personal Stake In the Resolution**

45

Standing

- Often in divorce proceedings or after such proceedings, a spouse as co-settlor may want to complain about the management of the trust by the soon to be ex-spouse.
- The complaints could be regarding distributions, investments, or self-dealing transactions by the trustee.
- One issue is whether the co-settlor has standing to complain about the trust management issues.

Standing

- Section 115.011 of the trust code confers standing on any "interested person" which is defined as "a trustee, beneficiary, or any other person having an interest in or claim against the trust or any person who is affected by the administration of the trust." See Tex. Prop. Code §§ 111.004(7) and 115.011(a).
- A "beneficiary," in turn, is defined as a person for whose benefit property is held in trust, regardless of the nature of the interest. *Id.* at § 111.004(2).
- The "interest" may be legal or equitable or both, present or future, vested or contingent, defeasible or indefeasible. *Id.* at § 111.004(6).
- Whether a person, excluding a trustee or named beneficiary, is an interested person may vary from time to time and must be determined according to the particular purpose of and matter involved in any proceeding. *Id.* at §111.004(7).

Standing

- A settlor of an irrevocable trust who is not a beneficiary generally does not have standing to complain about the trust. *Lee v. Rogers Agency*, 2016 Tex. App. LEXIS 10874, 2016 WL 7912460 (Tex. App.—Texarkana Oct. 6, 2016, pet. denied).
- If the spouse/settlor has a contingent remainder reversionary interest, that may be sufficient to be a “beneficiary” and have standing to bring suit. *In the Interest of K.K.W.*, No. 05-16-00795-CV, 2018 Tex. App. LEXIS 6539, 2018 WL 3968475 (Tex. App.—Dallas Aug. 20, 2018, pet. denied).
- A spouse as settlor has standing to assert a fraud claim. See *Gamboa v. Gamboa*, 383 S.W.3d 263 (Tex. App.—San Antonio 2012, no pet.) (“Patricia sued the trusts alleging they were Carl's alter ego, and were used to perpetuate fraud and to divest her of her share of the marital estate. Under these circumstances, the trial court correctly concluded Patricia was an “interested person” and was authorized to bring an action under the trust code.”).
- Spouse may be able to represent a minor child who is a beneficiary.

Trust Assets



Trust Assets

- A trust beneficiary's equitable interest in a trust has usually been characterized according to general rules. Thus, if the beneficial interest is acquired before marriage or through gift, devise, or descent, it will be separate property. *See Matter of Marriage of Burns*, 573 S.W.2d 555, 556–557 (Tex. Civ. App.—Texarkana 1978, writ dis.) (trusts established before marriage and testamentary trusts were separate property).
- The beneficial interest in a trust established by the trustor for his or her own benefit out of separate funds has also been treated as separate property. *See id.*

Trust Distributions



Trust Distributions

- Parties in divorce proceedings often argue about whether trust distributions are separate or community property.
- Distributions from testamentary or inter vivos trusts to married recipients who have no right to the trust corpus are the separate property of the recipient because these distributions are received by gift or devise. *See Benavides v. Mathis*, 433 S.W.3d 59 (Tex. App.—San Antonio 2014, pet. denied).

Trust Distributions

- In the context of a distribution of trust income under an irrevocable trust during marriage, income distributions are community property only if the recipient has a present possessory right to part of the corpus, even if the recipient has chosen not to exercise that right, because the recipient's possessory right to access the corpus means that the recipient is effectively an owner of the trust corpus.

Trust Distributions

- For example, in *Ridgell v. Ridgell*, 960 S.W.2d 144, 147-50 (Tex. App.—Corpus Christi 1997, no pet.), the wife received mandatory distributions of trust income, and, in addition, the testamentary trusts mandated that the trustee make annual distributions of trust corpus to the wife during the first eleven years of the marriage.
- The court held that the income distributions from the two testamentary trusts to the wife were community property.

De Facto Trustee

DE FACTO

De Facto Trustee

- A settlor does not owe fiduciary duties to the beneficiaries:
 - “Absent some assignment of duty to the settlor in the trust instrument, a trustee has no cause of action to sue the settlor of a trust for a breach of fiduciary duty to the trust beneficiaries. A trust settlor has no fiduciary obligation to a trust beneficiary once that trust is created, and control of the trust assets is vested with the trustee.”
- *Alpert v. Riley*, 274 S.W.3d 277, 292 (Tex. App.—Houston [14th Dist.] 2008, pet. denied).
- But what if the spouse/settlor still exercises control over the trust?

De Facto Trustee

- In *Bird v. Carl C. Anderson*, a trust beneficiary sued a defendant for usurping a trustee's role and breaching fiduciary duties as a de facto trustee. No. 03-21-00140-CV, 2021 Tex. App. LEXIS 5036 (Tex. App.—Austin June 24, 2021, no pet. history).
- The defendant filed a motion to dismiss under Texas Rule of Civil Procedure 91, arguing that there was no de facto trustee status in Texas, which the trial court denied.
- The court of appeals declined to accept an interlocutory appeal because resolving that issue would not materially advance the termination of the litigation due to the existence of similar alternative theories.

De Facto Trustee

- The court did imply that the defendant may owe fiduciary duties depending on the facts of the case even though he was not formally appointed a trustee:
- “[T]he trial court has yet to make the more salient determination of whether John owed the beneficiaries a fiduciary duty-either as a “de facto trustee” or under equitable principles-which is a question of law for the court that turns on the specific facts yet to be developed rather than on the legal capacity in which John was sued, considering that “fiduciary duties are equitable in nature and generally not subject to hard and fast rules.” Even if this Court were to determine that the “de facto” capacity does not exist, such determination would not materially advance the litigation’s termination because the issue of whether John owed the beneficiaries a fiduciary duty-in his individual capacity by allegedly and informally acting in the role of a trustee-would nonetheless remain a live issue.”

Trust Construction



Trust Construction

- In *Ochse v. Ochse*, a mother created a trust that provided that the trustee was authorized to make distributions to her son and the son's spouse. No. 04-20-00035-CV, 2020 Tex. App. LEXIS 8922 (Tex. App.—San Antonio November 18, 2020, pet. filed).
- At the time of the trust's execution, the son was married to his first wife, but he later divorced and married his second wife.
- The trial court and court of appeals both held that the terms "primary beneficiary's spouse" and "son's spouse" in the trust solely referred to the first wife because she was the son's spouse at the time the trust was executed.

Capacity Issues



Capacity Issues

- It is not usual for a spouse to wear multiple hats.
- He or she is a spouse, trustee, beneficiary, officer/director of a business, partner, etc.
- He or she will owe different duties depending on in which the capacity that he or she is acting.
- Business judgment rule may also protect actions taken as an officer or director.

Capacity Issues

- In *Benge v. Thomas*, a settlor created a trust and appointed her daughter, Missi, as the trustee. No. 13-18-00619-CV, 2020 Tex. App. LEXIS 6888 (Tex. App.—Corpus Christi August 27, 2020, no pet.).
- The trust owned an interest in a limited partnership that contained mineral interests.
- Missi’s daughter, Benge, was a beneficiary of the trust, and Benge sued Missi for various claims of breach of fiduciary duty arising from the operation of the limited partnership and other issues.
- The court held that the trust owned a limited partnership interest and as such had not authority over challenged transactions: “AFT Minerals would have had to bring these claims and not Missi in her capacity as trustee or Benge as a remainder beneficiary.”

Capacity Issues

- Bengé also complained that Missi did not keep adequate records of the trust, and specifically complained that “Missi had a duty to keep records of AFT Minerals’ transactions pursuant to her role as trustee of the 2012 Trust.”
- The court acknowledged that a trustee has a duty to maintain accurate records regarding a trust’s transactions, but disagreed that the trustee had a duty to maintain records regarding the transactions of a limited partnership that the trust has an interest in.

Co-Trustee Management



Co-Trustee Management

- Spouses are often co-trustees of trusts.
- A co-trustee has a duty to participate in the administration of the trust.
- A co-trustee can be liable for his or her co-trustee's actions and have a duty to correct breaches of fiduciary duty.
- A co-trustee has a duty cooperate with other co-trustees and may be removed for hostility.

Co-Trustee Management

- Absent language in a trust document to the contrary, co-trustee decisions are by a majority vote.
- For example, in *Duncan v. O'Shea*, three co-trustees brought a declaratory judgment action against a fourth co-trustee, seeking a declaration that the sale of trust real property was valid over the objection of the fourth co-trustee. No. 07-19-00085-CV, 2020 Tex. App. LEXIS 6564 (Tex. App.—Amarillo August 17, 2020, no pet.).
- The trial court granted the relief via summary judgment, and the fourth co-trustee appealed.

Co-Trustee Management

- The court of appeals held that the three co-trustees had the authority to sell the real property over the objection of the fourth co-trustee:
- “[T]he declaratory judgment granted does not specifically authorize the sale of any property. It merely declares that under applicable law and the terms of the Marital Trust, if Appellees, being a majority of the cotrustees, decide to sell a piece of real property held in the Marital Trust, then they may do so without her agreement. Appellees also note that if an actual sale violated the terms of the trust instrument or otherwise breached a fiduciary duty, Appellant would have a claim at that time.”

Co-Trustee Management

- If there is a deadlock, there are multiple ways to remedy the situation.
- A co-trustee can seek a court order directing the co-trustees to take action, can seek to modify the trust, can seek to remove the dissenting trustee, can seek to add an additional trustee, and can seek a receivership.

Children as Heirs/Beneficiaries



Children as Heirs/Beneficiaries

- Texas Estates Code Section 201.054(b) states with respect to an adopted child inheriting from an intestate natural parent, “[T]he adopted child inherits from and through the child’s natural parent or parents, except as provided by Section 162.507(c), Family Code.”
- Texas Family Code Section 162.507(c) expressly prohibits an adopted adult from inheriting from or through the adopted adult’s intestate biological parent.
- Texas Family Code Section 161.206(b)4 states: “[A]n order terminating the parent-child relationship divests the parent and the child of all legal rights and duties with respect to each other, except that the child retains the right to inherit from and through the parent *unless the court otherwise provides.*”
- Does not apply to wills or trusts.

Children as Heirs/Beneficiaries

- One important issue is whether adopted-in or adopted-out children count as descendants for wills and trusts.
- If a trust states that descendants are beneficiaries, then a child is adopted-out (non-beneficiary's parent's new spouse), is the child still a beneficiary?
- How about children that are adopted-in by a beneficiary?
- This largely depends on the interpretation of the will and trust and the language used by same.
- Other factors may also be important: what were the facts at the time the settlor/testator drafted the will, timing of the adoption, vesting of a class gift, etc.

Trust Distributions For Children

- A trust may provide for discretionary or HEMS distributions to the parent and/or the child.
- If just the parent, there is a authority that a trustee can make distributions to a beneficiary to support the beneficiary's dependents.
- If the parent and the child, a trustee should consider the ability of the parent to pay for the child, but that does not mean that the trustee should not make HEMS distributions for the child as well.
- In either case, the trustee can make distributions for the child's benefit to the custodial parent, even if that parent is not the beneficiary.

New Trust Code Provisions



New Trust Code Provisions

- In 2019, the Texas Legislature created Texas Property Code Section 112.001-112.106.
- These statutes address the effect of dissolution of marriage on certain transfers in trusts.
- This would make certain appointments (power of appointment, trustee, executor, agent, etc.) void.
- Also revokes certain dispositions of property to the spouse or the spouse's relatives.
- Also addresses splitting certain trusts where former spouses are co-settlors.

Conclusion



Conclusion

- Divorce proceedings are very emotional and adversarial.
- Due to this, trust issues can be dragged into divorce proceedings.
- This presentation was intended to address several common trust issues in divorce proceedings.