

Bad Boys, Bad Boys: Ramifications for Intentional Breaches Of Fiduciary Duties by Trustees

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Introduction

- A trustee owes its beneficiaries one of the highest duties known to law—this is a very special relationship.
- Due to the special nature of the fiduciary relationship, there is likely no area of law that has such a wide range of remedies available to a plaintiff than in *intentional* breach-of-fiduciary-duty cases.
- Example: *Wells Fargo v. Militello*, No. 05-15-01252-CV, 2017 Tex. App. LEXIS 5640 (Tex. App.—Dallas June 20, 2017), *vacated in part*, 2017 Tex. App. LEXIS 6546 (Tex. App.—Dallas, July 17, 2017, pet. denied).
- This presentation is intended to provide general guidance on the available remedies for intentional breach-of-fiduciary-duty claims.

Pre-Trial Remedies

- A plaintiff often needs to seek a remedy before trial to protect it from immediate injury.
- We are going to discuss pre-trial remedies that are potentially available to a plaintiff: Section 114.008, temporary injunctive relief, receiverships, and bonds.

Texas Trust Code Section 114.008

- A plaintiff may need to seek immediate relief from a court to prevent a fiduciary from selling assets, using assets, or improperly managing assets.
- Texas Trust Code Section 114.008(2) provides for a plethora of remedies:
 - (a) To remedy a breach of trust that has occurred or might occur, the court may:
 - (1) compel the trustee to perform the trustee's duty or duties;
 - (2) enjoin the trustee from committing a breach of trust;
 - (3) compel the trustee to redress a breach of trust, including compelling the trustee to pay money or to restore property;
 - (4) order a trustee to account;
 - (5) appoint a receiver to take possession of the trust property and administer the trust

Texas Trust Code Section 114.008

- (a) To remedy a breach of trust that has occurred or might occur, the court may:
 - (6) suspend the trustee;
 - (7) remove the trustee as provided under Section 113.082;
 - (8) reduce or deny compensation to the trustee;
 - (9) subject to Subsection (b), void an act of the trustee, impose a lien or a constructive trust on trust property, or trace trust property of which the trustee wrongfully disposed and recover the property or the proceeds from the property; or
 - (10) order any other appropriate relief.

Texas Trust Code Section 114.008

- The requirements for injunctive-type relief and receivership relief may be different (and less onerous) than at common law.
- There are statutes that allow for immediate appeals for injunctions and receivers, but orders under Section 114.008 may not apply for immediate appeal.

Temporary Injunctions

- The common law and Texas statutes provide authority for temporary injunctive relief. Texas Civil Practice and Remedies Code section 65.011 authorizes injunctive relief.
- To show a probable right of recovery, an applicant need not establish that it will finally prevail in the litigation; rather, it must only present some evidence that, under the applicable rules of law, tends to support its cause of action.
- In a fiduciary case, there is authority that the usual burden of establishing a probable right of recovery does not apply if the gist of the complaint is that a fiduciary is guilty of self-dealing.
- There is a presumption of unfairness.

Temporary Injunctions

- Irreparable injury must be imminent and not speculative.
- Evidence that a defendant may continue to divert fiduciary funds may be sufficient.
- There is authority that there is no irreparable-injury requirement when the defendant is a fiduciary.

Receiverships

- A plaintiff may wish to seek a receivership to have an independent third party manage assets pending the resolution of the plaintiff's claims.
- There are multiple statutes in Texas that allow for receivership relief. The most used statute allowing for receiverships is Texas Civil Practice and Remedies Code Chapter 64 that allows receiverships in specified types of cases and when permitted by the usages of equity. Tex. Civ. Prac. & Rem. Code § 64.001 et seq.
- Once again, a court may appoint a receiver for a trust under Texas Trust Code § 114.008 upon a finding that there has been a breach of trust “has occurred or might occur.”
- A receiver steps in and manages assets and takes other actions at the direction of the court, such as making distributions to beneficiaries.

Receiverships

- Texas Trust Code Section 114.008 provides for receivership relief as a remedy for breach of trust that “has occurred or may occur.” Tex. Prop. Code § 114.008.
- Are other equitable requirements necessary?
- Trust cases: *Estate of Benson*, No. 04-15-00087-CV, 2015 Tex. App. LEXIS 9477 (Tex. App.—San Antonio Sept. 9, 2015, pet. dismissed by agreement); *Elliott v. Weatherman*, 396 S.W.3d 224, 228 (Tex. App.—Austin 2013, no petition).

Bonds

- Most trust documents do not require a trustee to post a bond when accepting the position.
- A plaintiff may ask the court to require the defendant trustee to post a bond in an amount sufficient to cover the potential harm to the trust.
- Texas Trust Code, Section 113.058(d) provides that: “Any interested person may bring an action to increase or decrease the amount of a bond, require a bond, or substitute or add sureties. Notwithstanding Subsection (b), for cause shown, a court may require a bond even if the instrument creating the trust provides otherwise.” Tex. Prop. Code § 113.058.
- If there is concern and evidence that a trustee may not be able to reimburse a trust for trust harm, a beneficiary can file a motion to have the court require the trustee to post a bond in a certain amount.
- If the trustee later defaults, the beneficiary can then seek reimbursement from the sureties.

Removal

- Texas Trust Code Section 113.082 provides:
 - (a) A trustee may be removed in accordance with the terms of the trust instrument, or, on the petition of an interested person and after hearing, a court may, in its discretion, remove a trustee and deny part or all of the trustee's compensation if:
 - (1) the trustee materially violated or attempted to violate the terms of the trust and the violation or attempted violation results in a material financial loss to the trust;
 - (2) the trustee becomes incapacitated or insolvent;
 - (3) the trustee fails to make an accounting that is required by law or by the terms of the trust; or
 - (4) the court finds other cause for removal.
 - (b) A beneficiary, cotrustee, or successor trustee may treat a violation resulting in removal as a breach of trust.

Removal

- Removal actions can be tried at the same time as the underlying BOFD claims or it can be determined in an earlier hearing.
- There may be a right to a jury trial on underlying fact questions for removal relief. *See In re Poe* opinion.
- Under Section 114.008, a court can remove or suspend a trustee if there is a fight over the timing of a removal claim.

Equitable Remedies

- A fiduciary relationship is based in equity.
- Therefore, a court may award equitable remedies for breach of fiduciary duty.
- A trial court may order that the fiduciary forfeit compensation otherwise earned, disgorge improper gains and profits, or disgorge other consideration related to the breach of duty.

Compensation Forfeiture

- Under the equitable remedy of forfeiture, a person who renders service to another in a relationship of trust may be denied compensation for her service if he breaches that trust.
- The objective of the remedy is to return to the principal the value of what the principal paid because the principal did not receive the trust or loyalty from the other party.

Compensation Forfeiture

- Texas Trust Code Section 114.061 provides: “If the trustee commits a breach of trust, the court may in its discretion deny him all or part of his compensation.”
- Where equitable remedies exist, “the remedy of forfeiture must fit the circumstances presented.”
- There are several factors (not exclusive) for consideration when fashioning a particular equitable-forfeiture remedy: “[T]he gravity and timing of the violation, its willfulness, its effect on the value of the lawyer’s work for the client, any other threatened or actual harm to the client, and the adequacy of other remedies.”
- These factors are to be considered in determining whether a violation is clear and serious, whether forfeiture of any fee should be required, and if so, what amount.

Compensation Forfeiture

- In exercising its discretion, a court should consider the following factors: (1) whether the trustee acted in good faith or not; (2) whether the breach of trust was intentional or negligent or without fault; (3) whether the breach of trust related to the management of the whole trust or related only to a part of the trust property; (4) whether or not the breach of trust occasioned any loss and whether if there has been a loss it has been made good by the trustee; and (5) whether the trustee's services were of value to the trust.

Compensation Forfeiture

- The trial court should make that determination under the multiple-factor test based on the evidence in the case.
- The trial court can rule that the defendant should forfeit some, all, or none of the compensation.
- The remedy of forfeiture for a fiduciary's breach is dependent upon the facts and circumstances in each case.

Profit Disgorgement

- Disgorgement of profits or benefits is an equitable remedy appropriate when a party has breached his fiduciary duty; its purpose is to protect relationships of trust by discouraging disloyalty.
- Disgorgement of profits requires the fiduciary to yield to the beneficiary the profit or benefit gained during the time of the breach.
- Texas Trust Code Section 114.001(c) states: A trustee who commits a breach of trust is chargeable with any damages resulting from such breach of trust, including but not limited to: ... (2) any profit made by the trustee through the breach of trust.
- Disgorgement is distinct from an award of actual damages in that the disgorgement award serves a separate function of deterring fiduciaries from exploiting their positions of confidence and trust.

Profit Disgorgement

- “Disgorgement is compensatory in the same sense attorney fees, interest, and costs are, but it is not damages.”
- Disgorgement of profits requires the fiduciary to yield to the beneficiary the profit or benefit gained during the time of the breach.
- The fiduciary only has to disgorge “profits” and does not have to disgorge net revenues. *Longview Energy Co. v. Huff Energy Fund LP*, No. 15-0968, 2017 Tex. LEXIS 525 (Tex. June 9, 2017).

Profit Disgorgement

- It should also be noted that the trial court should order a fiduciary defendant to disgorge all improper profits, and there does not have to be a weighing of factors to determine whether and how much should be disgorged as there does in compensation forfeiture cases.

Consideration Disgorgement

- A plaintiff can potentially seek the disgorgement of contractual consideration from a defendant.
- *ERI Consulting Eng'rs, Inc. v. Swinnea*, 318 S.W.3d 867 (Tex. 2010).
- Court remanded for a determination of whether the forfeiture factors supported the trial court's award.
- The court of appeals affirmed that award after reviewing the factors.

Consideration Disgorgement

- *Cooper v. Sanders H. Campbell/Richard T. Mullen, Inc.*, No. 05-15-00340-CV, 2016 Tex. App. LEXIS 9253 (Tex. App.—Dallas August 24, 2016, no pet.).
- The court of appeals held that the record did not support the trial court's award, and remanded the case for further proceedings to allow the trial court to consider the appropriate legal standards, elements, and factors in awarding a forfeiture remedy.

Mental Anguish

- One particular subset of actual damages is mental anguish and/or emotional distress damages if the damages are a foreseeable result of a breach of fiduciary duty.
- For example, an attorney breached his fiduciary duty by disclosing a client's confidential information to a district attorney and an allegation of emotional distress constituted sufficient damage to sustain the claim.

Mental Anguish

- Intentional conduct necessary for recovery of mental anguish in attorney malpractice cases.
- “The term ‘mental anguish’ implies a relatively high degree of mental pain and distress. It is more than mere disappointment, anger, resentment or embarrassment, although it may include all of these. It includes a mental sensation of pain resulting from such painful emotions as grief, severe disappointment, indignation, wounded pride, shame, despair and/or public humiliation.”
- An award for mental anguish will normally survive appellate review if “the plaintiffs have introduced direct evidence of the nature, duration, and severity of their mental anguish thus establishing a substantial disruption in the plaintiff’s routine.”

Mental Anguish

- *Martin v. Martin*, the court of appeals reversed a mental anguish award against a trustee based on a claim of intentional breach of fiduciary duty because the beneficiary did not have sufficient evidence of harm. 363 S.W.3d 221 (Tex. App.—Texarkana 2012, pet. denied).
- *Wells Fargo v. Militello*, a court affirmed a mental anguish award against a trustee. No. 05-15-01252-CV, 2017 Tex. App. LEXIS 5640 (Tex. App.—Dallas June 20, 2017, pet. denied).

Punitive Damages

- Under Texas law, exemplary damages may be proper in a breach of fiduciary duty case where the plaintiff can prove by clear and convincing evidence that the action arose by actual fraud, malice, or gross negligence.
- A jury may only award exemplary damages if the claimant proves, by clear and convincing evidence, that the harm resulted from: (1) fraud; (2) malice; or (3) gross negligence. Tex. Civ. Prac. & Rem. Code Ann. § 41.003(a).

Punitive Damages: Definitions

- “Fraud” means fraud other than constructive fraud. Tex. Civ. Prac. & Rem. Code § 41.001(6).
- “Malice” means a specific intent by the defendant to cause substantial injury or harm to the claimant. *Id.* at 41.001(7).
- “Gross negligence” means an act or omission: (A) which when viewed objectively from the standpoint of the actor at the time of its occurrence involves an extreme degree of risk, considering the probability and magnitude of the potential harm to others; and (B) of which the actor has actual, subjective awareness of the risk involved, but nevertheless proceeds with conscious indifference to the rights, safety, or welfare of others. *Id.* 41.001(11).

Punitive Damages: Defendant Protections

- Protections for Defendants:
 - Exemplary damages may be awarded only if damages other than nominal damages are awarded;
 - An award of exemplary damages must be specific as to a defendant, and each defendant is liable only for the amount of the award made against that defendant;
 - On motion by a defendant, the court shall provide for a bifurcated trial so that in the second phase of the trial, the jury will determine the amount of exemplary damages to be awarded, if any;
 - Plaintiff must meet a clear and convincing evidence burden of proof (the measure or degree of proof that will produce in the mind of the trier of fact a firm belief or conviction as to the truth of the allegations sought to be established); and
 - Plaintiff must obtain a unanimous verdict for liability for and the amount of punitive damages.

Punitive Damages: Factors

- (a) In determining the amount of exemplary damages, the trier of fact shall consider evidence, if any, relating to:
 - (1) the nature of the wrong;
 - (2) the character of the conduct involved;
 - (3) the degree of culpability of the wrongdoer;
 - (4) the situation and sensibilities of the parties concerned;
 - (5) the extent to which such conduct offends a public sense of justice and propriety; and
 - (6) the net worth of the defendant.
- (b) Evidence that is relevant only to the amount of exemplary damages that may be awarded is not admissible during the first phase of a bifurcated trial.

Punitive Damages: Net Worth

- On the motion of a party and after notice and a hearing, a trial court may authorize discovery of evidence of a defendant's net worth if the court finds in a written order that the claimant has demonstrated a substantial likelihood of success on the merits of a claim for exemplary damages.
- If a trial court authorizes discovery, the court's order may only authorize use of the least burdensome method available to obtain the net worth evidence.
- "Net worth" means the total assets of a person minus the total liabilities of the person on a date determined appropriate by the trial court.
- "Assets of a person" include other trust assets where the defendant is a beneficiary?

Punitive Damages: Caps

- One important protection for defendants is the statutory cap on the amount of exemplary damages.
- The Texas Civil Practice and Remedies Code permits exemplary damages of up to the greater of: (1) (a) two times the amount of economic damages; plus (b) an amount equal to any noneconomic damages found by the jury, not to exceed \$750,000; or (2) \$200,000. Tex. Civ. Prac. & Rem. Code Ann. § 41.008(b).

Punitive Damages: Caps

- “Economic damages” means compensatory damages intended to compensate a claimant for actual economic or pecuniary loss; the term does not include exemplary damages or noneconomic damages.
- “Noneconomic damages” means damages awarded for the purpose of compensating a claimant for physical pain and suffering, mental or emotional pain or anguish, loss of consortium, disfigurement, physical impairment, loss of companionship and society, inconvenience, loss of enjoyment of life, injury to reputation, and all other nonpecuniary losses of any kind other than exemplary damages.

Punitive Damages: Cap Busting

- These limits do not apply to claims supporting misapplication of fiduciary property or theft of a third-degree felony level. Tex. Civ. Prac. & Rem. Code Ann. § 41.008(c)(10).
- The caps “do not apply to a cause of action against a defendant from whom a plaintiff seeks recovery of exemplary damages based on conduct described as a felony in the following sections of the Penal Code if ... the conduct was committed knowingly or intentionally....” *Id.*
- A person acts intentionally, or with intent, with respect to the nature of his conduct or to a result of his conduct when it is his conscious objective or desire to engage in the conduct or cause the result. Tex. Pen. Code § 6.03.
- A person acts knowingly, or with knowledge, with respect to the nature of his conduct or to circumstances surrounding his conduct when he is aware of the nature of his conduct or that the circumstances exist. A person acts knowingly, or with knowledge, with respect to a result of his conduct when he is aware that his conduct is reasonably certain to cause the result. *Id.*
- Accordingly, if a defendant is found liable for one of these crimes with the required knowledge or intent, it cannot take advantage of the statutory exemplary damages caps.

Punitive Damages: Misappl. of Fiduciary Property

- A person commits the offense of misapplication of fiduciary property by intentionally, knowingly, or recklessly misapplying property he holds as a fiduciary in a manner that involves substantial risk of loss to the owner of the property. Tex. Pen. Code § 32.45(b).
- “Substantial risk of loss” means a real possibility of loss; the possibility need not rise to the level of a substantial certainty, but the risk of loss does have to be at least more likely than not.
- A plaintiff must prove its entitlement to an exception to the exemplary damages cap.
- The Texas Pattern Jury Charge has a proposed jury question that a plaintiff can seek to submit to the jury.

Punitive Damages: Criminal Conduct

- In an action arising out of a criminal act committed by an employee, the employer may be liable for punitive damages but only if:
 - (1) the principal authorized the doing and the manner of the act;
 - (2) the agent was unfit and the principal acted with malice in employing or retaining him;
 - (3) the agent was employed in a managerial capacity and was acting in the scope of employment; or
 - (4) the employer or a manager of the employer ratified or approved the act.

Attorney's Fees

- Attorney's fees are not recoverable unless authorized by statute or provided for by contract.
- There is a specific statute that may allow an award of attorney's fees in trust disputes: Texas Trust Code § 114.064.
- This statute requires a finding of necessary and reasonableness and equitableness and justness.
- Evidence of intentional conduct by a defendant will make the decision much simpler for a court to find that an award of fees is equitable and just.

Potential Defenses

- A trustee may make any number of potential defenses, for example:
 - Just following the terms of the trust (see below);
 - Consent (formal and informal);
 - Release (sufficient knowledge);
 - Waiver, ratification, estoppel, quasi-estoppel, laches, etc.;
 - Advice of counsel (but waiver of privilege); and
 - Statute of limitations (must make disclosures).

Exculpatory Clauses

- Often a trust has terms that protect a trustee from certain actions or inactions.
- Are these terms enforceable, and if so, can they protect against liability for intentional actions?
- There are two types of exculpatory clauses: general no-liability clauses and specific no breach clauses.

Exculpatory Clauses

- Texas Trust Code Section 114.007 discusses the two different types of clauses mentioned earlier in this article.
- Section 114.007(a) provides:
 - (a) a term of a trust relieving a trustee of liability for breach of trust is unenforceable to the extent that the term relieves a trustee for liability:
 - (1) a breach of trust committed:
 - (A) in bad faith; (B) intentionally; or (C) with reckless indifference to the interest of the beneficiary; or
 - (2) any profit derived by the trustee from a breach of trust.
- So, general no liability clauses are not effective to protect against intentional misconduct.

Exculpatory Clauses

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

Exculpatory Clauses

- There are no express restrictions regarding bad faith, intentionally, or with reckless indifference to the beneficiary's interests or where the trustee acted with or without negligence where the trustee derived a profit.
- However, Section 114.007(c) does provide that it applies "except as provided in Section 111.035..."
- Section 111.0035 states, in part, that a trust term may not limit a trustee's "duty to act in good faith and in accordance with the purposes of the trust."

Exculpatory Clauses

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

Exculpatory Clauses

- The other type of powers clause is the type that allows a trustee to do something that it ordinarily cannot do.
- For example, a trust may allow a trustee to purchase property from the trust.
- The trustee ordinarily cannot enter into a self-dealing transaction, but this type of provision would allow a trustee to do so.
- However, the trustee would have to do so in good faith.

Determination of Remedy

- Is a plaintiff or defendant entitled to submit a requested remedy, or any aspect of it, to a jury or may a trial court alone determine the availability of the remedy?
- If requested, a jury should determine the amount of damages at law that should be awarded to a plaintiff where there is a fact issue.
- A court, in its equitable jurisdiction, should determine whether an equitable remedy should be granted.

Determination of Remedy

- If properly requested and preserved, a party is entitled to submit a fact issue on legal damages to a jury.
- However, if a party seeks an equitable remedy, the trial court normally has the sole right to resolve that request.
- If there is some underlying fact issue that must be resolved with regard to the equitable remedy, then that fact issue should be submitted to a jury.
- Parties should be very careful to evaluate all requested remedies before trial and determine what should be submitted to the court and what should be submitted to a jury.
- Otherwise, after trial, a court may determine that a party waived the right to a jury on a fact issue, and either refuse to award the remedy or grant the remedy and with supporting findings found in favor of the judgment.

Widening The Net

- A hot topic in the past few years is the use and confines of net widening theories such as knowing participation, aiding and abetting, and conspiracy to commit a breach of fiduciary duty.
- Generally, joint and several liability.
- Damages for conspiracy only applies after the defendant joins the conspiracy—complex causation issues now arise.

Conclusion

- There is no area of the law where remedies abound more than in fiduciary claims involving intentional breaches.
- In evaluating risk, clients need be aware of these remedies and the standards for same.
- The author hopes that this presentation assists in that analysis.