

Fixing or Killing Off Broken Trusts

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What we'll cover

- The basic stuff
 - Overview of modifications and terminations
 - Reformation and rescission
 - Nonjudicial modification or termination
- The fun stuff
 - Determining the purposes of the trust
 - Does a trustee have a duty to modify a trust?
 - Using the judicial modification statute to change trustees
 - Decanting and combination of trusts as alternatives to judicial modification
 - Charitable trust issues
 - Drafting with the future in mind

Resources

- This paper
 - This is where you will find detailed information on every aspect of judicial modifications
- texasprobate.com
- The Texas Probate Mailing List

The basic stuff

Overview of judicial modifications

- The doctrine of deviation (p. 6)
- Adoption of Trust Code in 1984: Section 112.054
 - Originally there were just two grounds for modification or termination --
 - 1. Purposes fulfilled or impossible to fulfill
 - 2. Because of unknown or unanticipated circumstances, compliance with trust terms “**would defeat or substantially impair the accomplishment of the purposes** of the trust”

Since 2005: *five* grounds for §112.054 actions (p. 13)

- 1. Purposes fulfilled or impossible to fulfill
- 2. Because of unknown or unanticipated circumstances, order “***will further the purposes*** of the trust”
- 3. Modification of “***administrative, nondispositive***” terms is necessary or appropriate to prevent waste or avoid impairment of the trust’s administration
- 4. Necessary or appropriate to achieve settlor’s tax objectives and is not contrary to the settlor’s intentions
- 5. Order is “not inconsistent with a material purpose of the trust” and all beneficiaries must agree

Other §112.054 issues

- Only a trustee or beneficiary may bring a §112.054 action (p. 10)
 - *Hubberd*: Mediator allowed to bring suit
- Compare standing and court actions permitted under §112.054 with standing and actions under §115.001 (p. 11, 23)
 - Construction versus modification
- Necessary parties, virtual representation and guardian ad litem (p. 24)
- Tax issues (remember *Bosch*)

Reformation and rescission (p. 20)

- Based on mistake of fact at the inception of the trust
 - Not a deviation or modification
 - Can be helpful for tax reasons
- Texas didn't adopt the equivalent of UTC Section 415 (reformation), so reformation remains an equitable remedy
 - What about the 2005 amendment to Section 112.054 regarding modifications to achieve settlor's tax objectives?
 - Compare to the 2015 will reformation statute (Tex. Est. Code §§255.451-255.455)
 - Possible change in 2017

Nonjudicial modification and termination (p. 29)

- Does the trust instrument permit modification or termination?
- Termination or modification permitted by statute
 - Revocation by settlor (Tex. Trust Code §112.051)
 - Merger (Tex. Trust Code §112.034)
 - Division and combination of trusts (Tex. Trust Code §112.057)
 - Decanting (Tex. Trust Code §§112.071 – 112.087)
 - Termination of uneconomic trust – less than \$50,000 (Tex. Trust Code §112.059)
 - Disclaimers (Tex. Prop. Code Chapter 240)
 - Termination by written agreement (Tex. Trust Code §114.032) – don't get your hopes up
- Termination by agreement of settlor and beneficiaries

The fun stuff

Determining the purposes of the trust (p. 15)

- Because of unknown or unanticipated circumstances, order “will further the purposes of the trust”
 - *Frost v. Newton* (prior to adoption of §112.054): the court shouldn’t try to determine the settlor’s “principal” and “incidental” purposes
 - *Hubberd*: (citing *Newton*) There were two purposes of the trust and the modification had to further *both* purposes
- For modification purposes, one broad purpose is better than multiple narrow purposes
 - Be sure to plead and prove the trust purpose
 - Consider including a broad purpose statement when drafting trusts

Does the trustee have a duty to modify a trust? (p. 38)

- Restatement (Third) of Trusts §66(2):
 - If a trustee knows or should know of circumstances justifying judicial modification of an **administrative provision** and of the potential of those circumstances to cause substantial harm to the trust or its beneficiaries, the trustee has a duty to petition the court for modification
 - Comments to §66(2):
 - Ordinarily there is no duty to modify distributive provisions
 - But if the trustee is **actually aware that a purpose of settlor would be jeopardized** by adhering to existing provisions, the trustee has a duty to petition the court for instructions or appropriate deviation

Using §112.054 to change trustees

- Tex. Trust Code §112.054(a): “...a court may order that the trustee be changed...”
 - Grounds for changing trustees – the same five described above
- Tex. Trust Code §113.082 – the trustee removal statute
 - Four grounds for removal, including “the court finds other cause for removal”


Decanting or combining trusts (p. 30)

- **Combination and division of trusts**
 - Tex. Trust Code §112.057 – must not impair the rights of any beneficiary or adversely affect achieving trust purposes
 - The trust instrument may contain more liberal combination and division powers
- **Decanting**
 - As a practical matter, decanting a “limited discretion trust” under the Texas statutes can fix only administrative provisions
 - 2017 changes may add to flexibility
 - Trust terms can give the trustee broader decanting power

Charitable trust issues (p. 35)

- The Uniform Prudent Management of Institutional Funds Act
 - Plead Section 112.054 and common law deviation
- Attorney general involvement
- Cy pres

Drafting with the future in mind (p. 2)

- Broad trustee discretion
 - Robust successor trustee provisions
 - Permit change of situs
 - Include a decanting provision
 - Creative use of trust protectors
 - Liberal division and combination provisions
 - Use care about including remote charitable beneficiaries
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