The Two UPIAs

The Uniform Prudent Investor Act and The Uniform Principal and Income Act – How They Will Change the World

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You can't stop us on the road to freedom. You can't stop us 'cause our eyes can see
Men with insight, men in granite, Knights in armor intent on chivalry.
She's as sweet as *UPIA* honey. She's an angel of the first degree.
She's as sweet as *UPIA* honey, just like honey from the bee.

– Van Morrison

There were significant changes to Texas trust law in 2003. All of the 2003 legislative changes are now effective. This paper addresses these changes, with emphasis on two new uniform acts – the Uniform Prudent Investor Act and the Uniform Principal and Income Act.

1. The Two UPIAs

The Texas Legislature enacted two significant trust bills in 2003 – the Uniform Prudent Investor Act of 1994 and the Uniform Principal and Income Act of 1997. These bills bring significant changes to the default rules governing how trusts are administered and accounted for in Texas.

a. The Uniform Prudent Investor Act

i. Tougher Standards for Trustees. A substantial majority of states have adopted versions of the Uniform Prudent Investor Act of 1994. Based on the Restatement (3rd) of Trusts: Prudent Investor Rule (1992) promulgated by the American Law Institute, the first "UPIA" modernizes the investment standard for trusts which do not specify another standard.

Previously, the default investment standard applicable to Texas trusts was found in Texas Trust Code § 113.056(a):

> . . . [A] trustee shall exercise the judgment and care under the circumstances then prevailing that persons of ordinary prudence, discretion, and intelligence exercise

> in the management of their own affairs, not in regard to speculation but in regard to the permanent disposition of their funds, considering the probable income from as well as the probable increase in value and the safety of their capital. In determining whether a trustee has exercised prudence with respect to an investment decision, such determination shall be made taking into consideration the investment of all of the assets of the trust . . . over which the trustee had management and control, rather than a consideration as to the prudence of the single investment of the trust. . . .

This was a Texanization of the prudent man rule (or, to be more politically correct, the prudent person rule) first espoused in *Harvard College v. Amory*, 26 Mass. (9 Pick.) 446, 461 (1830) (trustees should "observe how men of prudence, discretion and intelligence manage their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income, as well as the probable safety of the capital to be invested") and later included in a slightly different form in the Model Prudent Man Rule Statute (1942) and the Restatement (2nd) of Trusts (1959). Texas added the last sentence quoted above in 1991 to make the standard of prudence applicable to investments as a whole rather than each separate investment.

The Real Estate, Probate and Trust Law Section (REPTL) of the State Bar of Texas recently concluded a multi-year study of the new Uniform Trust Code. It concluded that the Uniform Trust Code as a whole is not an improvement over the current Texas Trust Code. However, it concluded that one part of the UTC -- the Uniform Prudent Investor Act -- should be adopted, with a few Texas-oriented changes.

The Texas version of the Uniform Prudent Investor Act replaces the prudent person rule with the prudent investor rule. The key objectives of the Act are:

- The standard of prudence is applied to any investment as part of the total portfolio, rather than to individual investments. UPIA § 2(b) [new Texas Trust Code Section 117.004(b)]. (This is similar to the 1991 amendment to Section 113.056.)

- The tradeoff in all investing between risk and return is identified as the fiduciary's central consideration. UPIA § 2(b) [new Texas Trust Code Section 117.004(b)].

- All categoric restrictions on types of investments have been abrogated; the trustee can invest in anything that plays an appropriate role in achieving the risk/return objectives of the trust and that meets the other requirements of prudent investing. UPIA § 2(e) [new Texas Trust Code Section 117.004(e)]. (Note, however, that several self-dealing prohibitions remain (e.g., Texas Trust Code §§ 113.052, 113.053, 113.054, 113.055 and 113.057).)

- The long familiar requirement that fiduciaries diversify their investments has been

integrated into the definition of prudent investing. UPIA § 3 [new Texas Trust Code Section 117.005].

Most of these objectives are reflected in Section 2 of the Act [new Texas Trust Code Section 117.004]:

SECTION 2. STANDARD OF CARE; PORTFOLIO STRATEGY; RISK AND RETURN OBJECTIVES.

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

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

(c) Among circumstances that a trustee shall consider in investing and managing trust assets are such of the following as are relevant to the trust or its beneficiaries:

(1) general economic conditions;

(2) the possible effect of inflation or deflation;

(3) the expected tax consequences of investment decisions or strategies;

(4) the role that each investment or course of action plays within the overall trust portfolio, which may include financial assets, interests in closely held enterprises, tangible and intangible personal property, and real property;

(5) the expected total return from income and the appreciation of capital;

(6) other resources of the beneficiaries;

(7) needs for liquidity, regularity of income, and preservation or appreciation of capital; and

(8) an asset's special relationship or special value, if any, to

the purposes of the trust or to one or more of the beneficiaries.

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

(e) A trustee may invest in any kind of property or type of investment consistent with the standards of this [Act].

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

The new standard requires much more of the trustee. Reduced to what is admittedly an oversimplification, the old prudent person rule was a passive, avoid-loss standard, while the new prudent investor rule is an active standard requiring the trustee to balance risk/return factors throughout the term of the trust.

ii. Delegation. The Texas version of the Uniform Prudent Investor Act varies very little from the uniform version of the Act. One variation is in the section of the Act which permits a trustee to delegate authority to make investment decisions and escape liability in some situations. Texas adopted the uniform act's delegation standard (which makes it easier for the trustee to avoid liability than the current Texas delegation statute – Texas Trust Code Section 113.060), but the Texas version provides additional safeguards. New Texas Trust Code Section 117.011(a) (which is in the uniform act) sets the initial requirements for a trustee wishing to delegate and avoid liability: the trustee must exercise reasonable care, skill and caution in (1) selecting the trustee, (2) establishing the scope and terms of the delegation (which terms must be consistent with the purposes and terms of the trust), and (3) monitoring the performance of the trustee. The uniform act provided that a trustee who complies with these three requirements is not liable to a beneficiary or the trust for the decisions or actions of the agent. The Texas legislature added three additional requirements, so that, in Texas, not only must the trustee comply with the three requirements of Section 117.011(a) to avoid liability for the acts of the agent, but also these three additional requirements must be met:

- The agent to whom the authority is delegated cannot be an affiliate of the trustee;
- The terms of the delegation cannot require the trustee or beneficiary to arbitrate disputes; or
- The terms of the delegation cannot shorten the statute of limitations.

See new Texas Trust Code Section 117.011(c).

The Texas version places a premium on agents who do not require arbitration. An individual trustee not wanting to meet the tougher investment standards of the Uniform Prudent

Investor Act has a good chance of avoiding liability for an investment agent's malfeasance if he or she delegates to a bank, trust company or investment firm which does not require arbitration, but he or she cannot avoid that liability if the bank, trust company or investment firm requires arbitration.

iii. Diversification; Problems with Concentrations. Under the new Uniform Prudent Investor Act, trustees have an affirmative duty to diversify investments [UPIA §3/new Texas Trust Code Section 117.005] and an affirmative duty to review the trust assets and to make and implement decisions concerning the retention and disposition of assets in order to bring them in compliance with the prudent investor rule [UPIA §4/new Texas Trust Code Section 117.006]. Gone will be the old Texas provision permitting retention of trust assets held at the inception of the trust without liability for diversification (see former Texas Trust Code §113.003). This creates new problems for trustees administering trusts with large concentrations of one investment (or type of investment in the trust). Concentration problems may arise in irrevocable life insurance trusts (ILITs), family farm and ranch trusts (for example, where the only significant asset is the family farm), trusts holding closely held business interests and trusts holding concentrations of the stock of the testator's former employer (for example, lifelong Exxon-Mobil employee with greater than 50% of his or her investments in Exxon-Mobil stock).

When analyzing a trust with a potential diversification/concentration problem, here are suggested steps for the trustee:

(1) First, consider meeting the diversification requirements of the new act. Obviously, if the investments can be diversified, the new statute is not a problem. Of course, there are times when this will be difficult or impossible.

(2) Fortunately for the trustee, most trusts contain language which provides relief from the diversification requirement. Therefore, the second thing a trustee should do is determine if the instrument overrides the diversification requirement.

(3) If diversification is not possible and the trust instrument does not authorize concentrations, the trustee should consider a judicial modification of the trust under Texas Trust Code §112.054 or a waiver and release from beneficiaries (see Texas Trust Code §114.032). Of these two approaches, the judicial modification provides the trustee with greater protection.

(4) If none of these alternatives are available, the trustee should seek protection under the statutory language. New Sections 117.004(c) and 117.005 both give some relief if diversification obviously is a bad idea.

iv. Effect on Existing Trusts. The Uniform Prudent Investor Act became effective January 1, 2004, and applies not only to new trusts but also to existing trusts. Like most of the current Texas Trust Code, the Uniform Prudent Investor Act imposes default rules -- rules which

apply if the trust instrument is silent. Settlors of trusts may override these new rules and impose whatever standards they wish, within the limits of public policy, statutes and the common law. As estate planning attorneys draft new trusts, they can consider whether it is appropriate to override the new act in whole or in part and draft accordingly. For specific drafting suggestions, see "Drafting Under the New Prudent Investor Standard" by C. Boone Schwartzel, 14th Annual Advanced Drafting: Estate Planning and Probate Course (2003). Provisions in existing trusts may override the new act, but of course the drafters of those trusts did not have the benefit of knowing the statute when the trusts were drafted, so they did not know what to override or how to go about overriding it.

Section 117.012 of the new act makes it harder to override the uniform act than one thinks. The new law primes the pump a little by providing that certain provisions that might be found in a trust instrument do not override the act but instead *invoke* the new act. Here is what new §117.012 says invokes the prudent investor rule and the new act:

> "investments permissible by law for investment of trust funds," "legal investments," "authorized investments," "using the judgment and care under the circumstances then prevailing that persons of prudence, discretion, and intelligence exercise in the management of their own affairs, not in regard to speculation but in regard to the permanent disposition of their funds, considering the probable income as well as the probable safety of their capital," "prudent man rule," "prudent trustee rule," "prudent person rule," and "prudent investor rule."

As noted above, there are differences between the old "prudent man rule" and the new "prudent investor rule," but Section 117.012 says that a trust instrument specifically providing for the "prudent man rule" in fact invokes the new prudent investor rule. It's time to dust off those old trust instruments to see if the language overrides the new act. In most cases, the only overriding language will be either (a) provisions drafted after the enactment of the new act which specifically refer to the new act (for example, "Settlor specifically provides that the prudent investor rule as espoused in Chapter 117 of the Texas Trust Code shall not apply to this trust"); (b) provisions requiring the trustee to invest in, or refrain from investing in, specific kinds of property (for example, "the trustee shall invest only in accounts insured by FDIC"); or (3) provisions which override certain sections of the new act without overriding the act as a whole (for example, provisions which waive the duty of diversification).

b. The Uniform Principal and Income Act

i. The Power to Adjust. The freedom to invest in a wide variety of investments granted by the prudent investor rule creates a serious accounting problem for the trustee: If the risk/return analysis makes it prudent to invest primarily in growth-oriented low-income-producing assets, how can the interests of the income beneficiary be protected? Harken back to yesteryear when a trustee free to invest in growth stocks could generate an annual return of 20% or more, but a trustee bound to generate income could hope for no more than a 5-6% return. Does the trustee have to forego these gains (and incur the wrath of the remainder

beneficiaries) in order to assure the income beneficiary a reasonable return?

Under the Uniform Principal and Income Act of 1997, the answer is no – at least in some cases. Section 116.105 of the second "UPIA" permits the trustee to adjust between principal and income to the extent the trustee considers necessary if the trustee is following the prudent investor rule and cannot otherwise balance the interests of the income beneficiary and the remainder beneficiaries fairly. There are restrictions on this power to adjust. For example, the trustee of a marital deduction (QTIP) trust cannot use the adjustment power to move income away from the surviving spouse, although it can be used to make adjustments which add to trust income.

REPTL considered the Uniform Principal and Income Act to be a necessary adjunct to the Uniform Prudent Investor Act -- if the Legislature was going to adopt the prudent investor rule, it also needed to adopt accounting rules to assure that the relative rights of the beneficiaries are protected. The result is that Texas has two new uniform acts – the Uniform Prudent Investor Act and the Uniform Principal and Income Act.

As a result of this new power to adjust, trustees are faced with a new set of discretion decisions to make. There are two prongs to the power-to-adjust analysis:

(1) ***Can*** **the trustee exercise the power to adjust?** The power to adjust is available only in limited cases, so the first thing for the trustee to do is to determine if it is available with respect to a particular trust. Here are common reasons why the power to adjust may not be available:

(a) The power to adjust is available only if the trustee is investing the trust as a prudent investor. This means that the power to adjust cannot be used if the trust provides for a different investment standard or if the trust holds an undiversified concentration based on a provision in the trust instrument which overrides the diversification rule.

(b) The power to adjust is available only in cases where what is defined as income is relevant to the distribution standard. If the trustee has the power to make income and principal distributions to a beneficiary based on the same HEMS (health, education, maintenance and support) standard, then the power to adjust is not available since it does not really matter to the income beneficiary what is defined as income and what is defined as principal. On the other hand, in a trust where the trustee is required to distribute all of the income to the income beneficiary and there is no principal invasion standard, the power to adjust may be available (assuming other conditions are met) since what is defined as income is relevant to what the income beneficiary receives.

(c) The power to adjust is not available if the trustee also is a beneficiary of the trust. This may justify the use of a corporate trustee or other independent trustee in cases where a beneficiary/trustee was appropriate under the prior law. Also, estate planning attorneys should consider including a provision in the trust boilerplate that permits a

trustee/beneficiary to appoint one or more co-trustees who could act alone to make the adjustment if necessary.

(2) *Should* the trustee exercise the power to adjust? If the trustee determines that the power to adjust is available, the trustee must use its discretion to determine whether or not to make the adjustment. It seems likely that the Texas version of the Uniform Principal and Income Act will be construed to mean that the power to adjust decision must be made annually – the trustee cannot merely set an appropriate income return figure at the outset of a trust and never review the decision. A trustee may be found to have abused its discretion not only for making an adjustment when it should not have done so but also for failing to make an adjustment it should have made or for making the adjustment in an incorrect way or amount. Section 116.005(b) lists factors which the trustee should consider in deciding whether or not to make an adjustment. The statute does not state in percentage terms what is a reasonable rate of return for an income beneficiary, but it appears that most corporate fiduciaries are going to apply factors which are likely to yield a return of between 3 and 5 percent.

ii. Unitrusts. Several states have considered addressing the need to adjust between income and principal which arises under the prudent investor rule by allowing trustees to convert income-only trusts into unitrusts. This approach was considered in Texas and rejected for now. The unitrust conversion statutes are evolving. Eventually there may be a generally accepted, fair way to permit trustees to convert income-only trusts into unitrusts, but the current attempts in other states seem flawed in that they are overly complicated or likely to be unfair to beneficiaries.

While the unitrust conversion concept was left out, the Texas version of the Act contains a provision [new Texas Trust Code Section 116.007] which permits a settlor to draft a non-charitable unitrust. This provision is intended to take advantage of Proposed Treasury Regulation 1.643(b)-1, 66 Fed. Reg. 10396 (February 15, 2001), which provides that amounts allocated between income and principal pursuant to applicable local law will be respected if local law provides for a reasonable apportionment between the income and remainder beneficiaries of the total return of the trust. Under the proposed regulation, a state law that provides for the income beneficiary to receive each year a unitrust amount of between 3% and 5% of the annual fair market value of the trust assets is a reasonable apportionment of the total return of the trust. New Texas Trust Code Section 116.007 provides support in Texas law for a settlor who wishes to create a non-charitable unitrust paying a unitrust amount of between 3% and 5% by defining such amount as "income" for state fiduciary accounting purposes. If the proposed regulation becomes final, this should make it unnecessary for a settlor to provide for the payment of the greater of the unitrust amount or actual income in order to meet tax requirements for a trust which requires the distribution of all income to a beneficiary (for example, a marital deduction (QTIP) trust). The provision does not require that trust income be defined in terms of a unitrust percentage, nor does it provide a means for converting an all-income trust into a unitrust. Because other rules apply to charitable unitrusts, this proposal does not apply to them.

iii. Judicial Control of Discretionary Power. While the Texas version of the Uniform Principal and Income Act does not contain a unitrust conversion provision, it does

contain another controversial provision – Section 105 of the uniform act. Section 105 was not a part of the Uniform Principal and Income Act as first adopted by the National Conference of Commissioners on Uniform State Laws (NCCUSL). It was added as an afterthought when states such as California started adopting provisions permitting a trustee to cut off a beneficiary's rights by giving him or her notice of the trustee's intention to make an adjustment under Section 104. REPTL considered the provision ill-conceived and unnecessary and did not include it in the version of the act originally introduced in the Legislature. However the Trust Services Division of the Texas Bankers Association (TBA) insisted on inserting the provision. Until very late in the legislative session, it appeared that the two UPIAs would fail to be enacted because of this provision. However, REPTL and TBA reached a compromise to save the two bills, resulting in a modified version of Section 105 being included as new Texas Trust Code Section 116.006.

Subsections (a) and (c) of Section 116.006 provide some cover for a trustee who worries that its decision to make (or not make) an adjustment will be second-guessed by a beneficiary. Subsection (a) provides that a court may not change a trustee's decision about an adjustment unless the court finds that the trustee abused its discretion and that it is not an abuse of discretion simply because the court may have decided to make the adjustment differently. This is consistent with case law on the subject, but it provides some statutory protection for trustees. Subsection (c) provides that, in cases where an abuse of discretion is found to have occurred, the monetary remedy is to be accomplished in the way that is the least painful to the trustee – future distributions to beneficiaries will be adjusted to compensate for the abuse of discretion, and only if the parties cannot be put back in the right positions by adjusting future distributions will the trustee be tagged personally for damages.

The most controversial part of new Section 116.006 is subsection (d), which permits the trustee to obtain what amounts to an advisory opinion about an adjustment decision the trustee is considering making. The REPTL/TBA compromise language permits the trustee to initiate this proceeding only if it has reasonable grounds for believing that one or more beneficiaries will object to the adjustment, and a beneficiary's failure or refusal to sign a waiver or release cannot form the basis of this belief. If a proceeding is initiated, the trustee is required to fund the beneficiaries' legal fees from the trust, and the court is permitted at the conclusion of the proceeding to determine which party should bear the attorney's fees and costs. It could let the costs come from the trust, assess them against the trustee, make one or more beneficiaries pay the costs, or use some combination of the above.

iv. New Accounting Rules. The Uniform Principal and Income Act comprehensively treats the subject of allocating receipts and disbursements between principal and income and, therefore, replaces Subchapter D of Chapter 113 of the Texas Trust Code (§§113.101 -- 113.111). This means that trustees, their lawyers and their accountants will have to learn some new rules. The rules make a number of changes to prior law and address many new types of investments, such as asset-backed securities. In general, the new act has a bias toward principal, starting with one of its general principles expressed in new Section 116.004(a)(4) – if no provision of the trust or statute says what an item is, then it's principal.

By and large, the Texas version of the Act sticks with the allocation rules contained in the uniform act. However, the Texas version varies from the uniform version in some key areas.

Here are some of the differences between the old Texas accounting rules and the new Uniform Principal and Income Act rules:

(1) Oil, Gas and Mineral Income. Texas rejected the uniform act's provision regarding oil and gas royalties, which would have made 90% of each royalty check principal and only 10% income. However, the Legislature did not stick with the old Texas rule (which made 27½ % of royalties principal and the rest (72½%) income – see former Texas Trust Code §113.107) either. The new Texas statute (Trust Code §116.174) provides that the trustee must allocate these receipts "equitably." It further provides that an allocation is presumed to be equitable if the amount allocated to principal equals the amount allowed as a deduction by the Internal Revenue Code for depletion of the interest. Finally, the Texas version includes a grandfather provision for existing trusts -- if oil and gas receipts were being allocated under the old 27½ / 72½ % rule, the trustee can keep using that allocation formula.

(2) Timber. The former Texas law (former Section 113.108) required timber receipts to be allocated reasonably and equitably. The new statute (Trust Code §116.175) requires the trustee to determine the rate of harvesting and the rate of growth of a particular timber asset. To the extent the rate of harvest does not exceed the rate of growth, the proceeds are income. To the extent the rate of harvest exceeds the rate of growth, proceeds are principal.

(3) Retirement Plans. The uniform act's rule on distributions from IRAs and other retirement plans was that 90% of each distribution was principal and 10% was income. It is rare for the IRA or retirement plan to be in an income-only trust (although it is not unheard of for the IRA to be placed in a marital deduction (QTIP) trust benefitting the second spouse for life with remainder to children of the first marriage), but in cases where this happens the uniform act would provide very little for the income beneficiary. The former Texas provision (former Texas Trust Code §113.109) was fairer to the income beneficiary, but its approach (5% of the inventory value of the deferred payment right) was confusing, difficult to apply and did not adequately take into account changes in the value of the underlying asset. The Texas version of UPIA contains a unique Texas provision which borrows from unitrust principles: a required payment is income to the extent of 4% of the asset's value and is principal to the extent it exceeds 4% of the asset's value. Unfortunately, the language REPTL suggested for inclusion in the act was changed during the legislative process, and the changes garble its meaning pretty badly. This is an area where the official Section comments are helpful in construing the statute.

(4) Receipts from Entities. One of the advantages of the new principal and income act is that it addresses the changed investment environment of today. A good example of this is new Section 116.151. Former law had a section on corporate distributions (former Trust Code §113.104). The new provision addresses the broader question of distributions from all types of entities and not just corporations. In general, under Section 116.151, a receipt of cash from an entity is income, while a receipt of non-cash property (such as a stock dividend) is

principal. The new act also provides that money received from an entity that is greater than 20 percent of its value can be considered to have been received in partial liquidation of the entity and, therefore, principal. This partial liquidation provision is a potential trap that trustees and closely held entities with trusts holding significant ownership interests should review carefully.

(5) Business Conducted by Trustee. Under old Texas law (former Section 113.106), a trustee could continue a business of which the settlor was a sole proprietor in some cases and apply generally accepted accounting principles (GAAP), rather than trust accounting prinicples, to receipts and disbursements. Under new Section 116.153 of the Uniform Principal and Income Act, the trustee is not limited to using this GAAP approach to cases in which the settlor operated the business as a sole proprietor. Rather, the trustee can use the approach in a number of situations where GAAP rules may be easier (and more sensible) to use that strict principal and income trust accounting rules (for example, farming and ranching operations, timber operations, oil and gas operations, etc.).

The new and old trust accounting rules are summarized and compared in Chapter 8.

v. Effect on Existing Trusts. Like the Uniform Prudent Investor Act, the Uniform Principal and Income Act became effective January 1, 2004, and applies not only to new trusts, but also to existing trusts. There are some grandfather provisions (the most significant being the one that applies to mineral interests), but in general the accounting rules for existing trusts changed on January 1, 2004. Also, the Texas Uniform Principal and Income Act is a default statute -- if the trust instrument is silent, its rules apply, but if the trust instrument specifies other rules, those other rules apply.

2. Exculpatory Provisions

On December 31, 2002, the Texas Supreme Court issued its opinion in *Texas Commerce Bank, N. A. v. Grizzle,* 96 S. W. 3d 240 (Tex. 2002). The *Grizzle* case took a very broad view of Section 113.059 of the Texas Trust Code which, if taken to its logical conclusion, could have meant that the settlor of a trust could override all statutory and common law trustee duties, so long as he or she did not attempt to relieve a *corporate* trustee from the prohibited actions in Section 113.052 and 113.053. For example, the *Grizzle* opinion left open the door to a trustee being exculpated for actions taken in bad faith or with reckless indifference and to flatly refusing to give any kind of accounting, if the trust instrument backs him or her up. Reasonable minds differ about whether *Grizzle* can be read to reach this far, but the Legislature chose to respond to *Grizzle* by amending Trust Code §113.059 to incorporate the provisions of the Restatement (2nd) of Trusts, §222, which 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. It also may not relieve the trustee for liability for any profit derived by the trustee from a breach of trust (HB 3503).

Another reaction to *Grizzle* were amendments to the statutes governing 142 Trusts (Texas Property Code §142.005) and 867 Trusts (Texas Probate Code §867). These amendments make

any provision in one of these court-created trusts unenforceable to the extent that it limits the liability of a trustee beyond that imposed by the Texas Trust Code, unless there is a specific finding by clear and convincing evidence that the specific property of that trust justifies the exculpation provision (HB 3503).

The changes made by HB 3503 became effective on September 1, 2003, and apply not only to new trusts but to existing trusts as well.

Here are a few practice pointers in light of the *Grizzle* case and the anti-*Grizzle* legislation:

a. Since most settlors don't exculpate trustees for bad faith actions or reckless indifference, most exculpation clauses will not cross the line drawn by HB 3503 except possibly in one case: liability for profit derived from breach of trust. Since the new law applies to existing trusts, for existing trustee clients, see if the trust instrument contains an exculpation provision which crosses the line and warn the client if it does.

b. One consequence of HB 3503 is that it is now clear how far an exculpation provision can go. Therefore, in drafting situations where the settlor wishes to include the broadest possible exculpation provision, following the statutory language should allow the drafter to paint precisely within the lines. However, please, *please,* ***please*** don't stick exculpation provisions in the boilerplate – they should only be used in special, limited circumstances.

c. Exculpation clauses in existing 142 Trusts and 867 Trusts became unenforceable on September 1, 2003, unless the court makes the new, specific finding that the exculpation provision is justified. Be sure to notify clients who are trustees of existing 142 Trusts and 867 Trusts.

d. When creating new 142 Trusts and 867 Trusts, consider whether or not the specific facts exist to justify an exculpation provision. If so, be sure to seek and obtain the necessary court finding. Don't just stick an exculpation provision in the trust.

The full text of HB 3503 (with the new exculpatory provisions) is found in Chapter 4.

3. Trust Accountings

HB 1471, which became effective September 1, 2003, amended Section 113.151(a) of the Trust Code to impose a 90-day deadline for trust accountings. Previously the accounting was due in a "reasonable time." Under the change, the trustee can ask a court to extend the deadline in appropriate cases. The amendments to this section also permit a beneficiary who is forced to bring a lawsuit to enforce the accounting demand to recover attorney's fees and costs from the trust or the trustee, in the discretion of the court.

4. Trustee Removal

HB 1471, which became effective September 1, 2003, amended Section 113.082 of the Trust Code to make it clear that, upon the occurrence of one of the specific grounds for removal of a trustee listed in the statute, the court may *in its discretion* remove the trustee. Yes, "may" should be sufficient to make it clear that the court's authority is discretionary without the addition of "in its discretion," but two cases (*Akin v. Dahl,* 661 S. W. 2d 911, 913 (Tex. 1983), and *Lee v. Lee,* 47 S. W. 3d 767, 785-6 (Tex. App. — Houston [14th Dist.] 2001)) called this into question. The amendment also adds the failure to make an accounting required by law or the trust instrument to the list of specific, discretionary grounds for removal.