

Modification and Termination of Trusts, and Trustee Resignation

Authored by:

Jason A. Cox
Tammy C. Manning
Galligan & Manning

Presented by:

Tammy C. Manning
Galligan & Manning

Modification and Termination of Trusts, and Trustee Resignation

I. Introduction

In many jurisdictions recently, Texas included, traditional rules concerning revocation, termination, and modification of trusts have been relaxed to facilitate the making of changes in the terms of trusts.

In 2005, the Texas legislature – in response to a multi-year study of the Uniform Trust Code (2000) conducted by the Real Estate, Probate and Trust Law Section of the State Bar of Texas – made several changes to the Texas Trust Code directly affecting a court's power to modify and terminate trusts.¹

These changes resulted in an amended version of Section 112.054 of the Texas Property Code, which, while not adopting it in full, incorporates several provisions of the Uniform Trust Code (specifically, Sections 411, 412, and 416).²

These changes reflect both (i) modern trends in legislative policy and judicial decisions and (ii) practical considerations arising from other developments in or affecting estate planning.³

Estate planning in Texas has become increasingly complex; this is due in large part to changes in tax laws, as well as an inability to take into consideration unexpected and unanticipated circumstances that might affect a trust and/or its beneficiaries. These problems have increased as larger numbers of people recognize the utility of trusts for a

¹ HOUSE COMM. ON JUDICIARY, Bill Analysis, H.B. 1190, 79th Leg., R.S. (2005).

² See *id.*

³ See RESTATEMENT (THIRD) OF TRUSTS, Chapter 13, Introductory Note.

variety of purposes, with many settlors relying on the advice of non-lawyers promoting living trust ‘kits.’⁴

There are also more fundamental reasons for the liberalization trend: namely, the recognition that trusts should serve a beneficiary’s best interest, and greater flexibility can aid in the achievement of a settlor’s objectives.⁵ The pendulum seems to be swinging away from following the settlor’s intent to satisfying the beneficiaries’ desires.

While the ‘new’ Section 112.054 does not go as far as the Uniform Trust Code (which, in turn, does not go as far as the Restatement (Third) of Trusts, upon which much of the UTC is based), the changes are far-reaching and make it much easier for a party (settlor, beneficiary, trustee, otherwise interested party, or a combination thereof) to petition the court to modify a trust’s terms or terminate the trust altogether.

II. History of Modification and Termination of Trusts in Texas

The prior version of Section 112.054 of the Texas Property Code, the statute governing judicial modification and termination of trusts in Texas, rigidly followed the *Clafin* doctrine,⁶ which prevented premature termination of trusts, unless the trust’s material purposes had been accomplished, even if all beneficiaries were not under any legal disability, able to bring the suit in their own capacity, and agreed to terminate the trust.⁷ This version of the statute placed emphasis on honoring a settlor’s intent, and

⁴ See *id.*

⁵ See *id.*

⁶ Eun C. Han, Notes & Comments, *Premature Judicial Termination of Non-Spendthrift Trusts: Reconciling a Dead Settlor’s Intent with a Living Beneficiary’s Needs*, 3 TEX. WESLEYAN L. REV 191 (1996).

⁷ The *Clafin* doctrine arose from the case of *Clafin v. Clafin*, 149 Mass. 19, 20 N.E. 454 (1889). In this case, a trust was established for a testator’s son, with principal to be paid to the son at age 30. After age 21, the son sued to terminate the trust, pointing out that he was the sole beneficiary. The court refused to permit termination as this would violate the intent of the testator. Later cases amplified the *Clafin* rule, so even significant ‘changed circumstances,’ like the need to settle litigation, would not serve as grounds for

providing certainty and predictability by restricting early trust termination by petition to the court.⁸

*Lanius v. Fletcher*⁹ established the *Clafin* doctrine in Texas.¹⁰ In *Lanius*, the Court held that a property owner had an absolute right to dispose of property in any manner they wished, and that imposing restrictions on the property's use was legitimate as long as those restrictions did not violate law or public policy.¹¹

This rigid application of the *Clafin* doctrine was refined in 1971 in *Alamo National Bank v. Daubert*,¹² when the Beaumont Court of Appeals permitted the premature termination of a trust where the trust's primary purpose – as opposed to any other *incidental* purpose – had been fulfilled.¹³

The Texas Supreme Court, however, reversed the more liberal approach adopted by the *Alamo* Court in *Frost National Bank v. Newton*,¹⁴ holding that beneficiaries of a trust can consent to that trust's termination only when all purposes (as opposed to the primary purpose) of the trust had been accomplished, thus rejecting the 'primary' versus 'incidental' purpose analysis employed in *Alamo*. The *Frost* Court also held that if a trust expressly stated that it terminated upon specific events, that premature judicial termination would not be permitted (even if the trust's purposes had been fulfilled).¹⁵

trust termination. See Kumar Paturi and Robert Whitman, *Improving Mechanisms for Resolving Complaints of Powerless Trust Beneficiaries*, 2 CONN. PUB. INT. L. J. 37 (Fall 2002) (citations omitted).

⁸ Han, *supra* note 6, at 198.

⁹ 101 S.W. 1076 (Tex. 1907).

¹⁰ Han, *supra* note 6, at 198.

¹¹ See *Lanius*, 101 S.W. at 1076.

¹² 467 S.W.2d 555 (Tex. Civ. App. – Beaumont 1971, writ ref'd n.r.e.).

¹³ In *Alamo*, the court held that the primary purpose of the trust at issue was health, support, and maintenance of the settlor's daughter until age 35; an *incidental* purpose of the trust was a contingent interest in the trust owned by the mother of the beneficiary. Once the daughter/beneficiary turned 35, the *Alamo* Court reasoned the trust's primary purpose had been fulfilled, and the trust could be terminated prematurely. See generally *Alamo*, 467 S.W.2d 555.

¹⁴ 554 S.W.2d 149 (Tex. 1977).

¹⁵ See *id.*, at 154.

The Texas legislature codified *Frost* in the Texas Property Code in 1985,¹⁶ and it is this version of Section 112.054 that the legislature amended in 2005.

III. Present Version of Texas Property Code Section 112.054

The present version of the statute reads as follows (recent changes from prior statute are in bold):

§ 112.054. JUDICIAL MODIFICATION OR TERMINATION OF TRUSTS.

(a) On the petition of a trustee or a beneficiary, a court may order that the trustee be changed, that the terms of the trust be modified, that the trustee be directed or permitted to do acts that are not authorized or that are forbidden by the terms of the trust, that the trustee be prohibited from performing acts required by the terms of the trust, or that the trust be terminated in whole or in part, if:

(1) the purposes of the trust have been fulfilled or have become illegal or impossible to fulfill;

(2) because of circumstances not known to or anticipated by the settlor, **the order will further the purposes of the trust;**

(3) **modification of administrative, nondispositive terms of the trust is necessary or appropriate to prevent waste or avoid impairment of the trust's administration;**

(4) **the order is necessary or appropriate to achieve the settlor's tax objectives and is not contrary to the settlor's intentions; or**

(5) **subject to Subsection (d):**

(A) continuance of the trust is not necessary to achieve any material purpose of the trust; or

(B) the order is not inconsistent with a material purpose of the trust.

(b) The court shall exercise its discretion to order a modification or termination under Subsection (a) in the manner that conforms as nearly as possible to the probable intention of the settlor. The court shall consider spendthrift provisions as a factor in making its decision whether to modify or terminate, but the court is not precluded from exercising its discretion to modify or terminate solely because the trust is a spendthrift trust.

¹⁶ Han, *supra* note 6, at 198.

(c) The court may direct that an order described by Subsection (a)(4) has retroactive effect.

(d) The court may not take the action permitted by Subsection (a)(5) unless all beneficiaries of the trust have consented to the order or are deemed to have consented to the order. A minor, incapacitated, unborn, or unascertained beneficiary is deemed to have consented if a person representing the beneficiary's interest under Section 115.013(c) has consented or if a guardian ad litem appointed to represent the beneficiary's interest under Section 115.014 consents on the beneficiary's behalf.

See TEX. PROP. CODE § 112.054 (emphasis added).

As noted above, the foregoing amendments were made to the statute in 2005; unless otherwise provided by a will or trust, this section is effective for trusts existing or created on or after January 1, 2006, probate or administration of estates pending on or after January 1, 2006, and estates of decedents who die on or after January 1, 2006.

Presently, there is little or no case law directly interpreting the most recent amendments to Section 112.054. Therefore, to better understand how these new changes are meant to work, it is helpful to refer to the sections of the Uniform Trust Code upon which they are based.

IV. Uniform Trust Code Sections 411, 412, and 416

A. Uniform Trust Code Section 411

Section 411 of the Uniform Trust Code describes the circumstances in which termination or modification of a noncharitable irrevocable trust may be compelled by the beneficiaries, with or without concurrence of the settlor.¹⁷ This Section states:

(a) A noncharitable irrevocable trust may be modified or terminated upon consent of the settlor and all beneficiaries, even if the modification or termination is inconsistent with a material purpose of the trust. A settlor's power to consent to a trust's modification or termination may be exercised by an agent under a power of attorney only to the extent expressly authorized by the power of attorney or the terms of the trust; by the settlor's

¹⁷ See UNIF. TRUST CODE § 411 (amended 2004) commentary.

[conservator] with the approval of the court supervising the [conservatorship] if an agent is not so authorized; or by the settlor's [guardian] with the approval of the court supervising the [guardianship] if an agent is not so authorized and a conservator has not been appointed.

(b) A noncharitable irrevocable trust may be terminated upon consent of all of the beneficiaries if the court concludes that continuance of the trust is not necessary to achieve any material purpose of the trust. A noncharitable irrevocable trust may be modified upon consent of all of the beneficiaries if the court concludes that modification is not inconsistent with a material purpose of the trust.

(c) A spendthrift provision in the terms of the trust is not presumed to constitute a material purpose of the trust.

(d) Upon termination of a trust under subsection (a) or (b), the trustee shall distribute the trust property as agreed by the beneficiaries.

(e) If not all of the beneficiaries consent to a proposed modification or termination of the trust under subsection (a) or (b), the modification or termination may be approved by the court if the court is satisfied that:

(1) if all of the beneficiaries had consented, the trust could have been modified or terminated under this section; and

(2) the interests of a beneficiary who does not consent will be adequately protected.

See Uniform Trust Code § 411.

Subsection (a) of Section 411 states the test for termination or modification by the beneficiaries with the concurrence of the settlor, and subsection (b) states the test for termination or modification by unanimous consent of the beneficiaries without the concurrence of the settlor.¹⁸ These subsections parallel provisions in the Restatement (Third) of Trusts (which in fact goes further by allowing beneficiaries to compel termination of a trust that still serves a material purpose if the reasons for termination outweigh the continuing material purpose of the trust).¹⁹ The rules on trust termination in

¹⁸ See *id.*

¹⁹ See *id.*; see also RESTATEMENT (THIRD) OF TRUSTS § 65(2).

these subsections incorporate a less stringent version of the *Clafin* doctrine²⁰ (described in further detail above), Subsection (e) creates a procedure for judicial approval of a proposed termination or modification when there is no unanimous consent among all the beneficiaries.²¹

Subsection (b) also provides that the beneficiaries may modify any term of the trust if the modification is not inconsistent with a material purpose of the trust.²² The requirement that the trust no longer serve a material purpose before the beneficiaries can terminate it does not mean that the trust has no remaining function.²³ In order to be material, the purpose remaining to be performed must be of some significance.²⁴

One can see the liberalizing influence of Section 411 in Sections 112.054(a)(1) and 112.054(a)(5) of the Texas Statute, which allow for termination of the trust if the trust's terms have been fulfilled or have become illegal or impossible to fulfill, or if continuance of the trust is not necessary to achieve any material purpose of the trust.

B. Uniform Trust Code Section 412

Section 412 of the Uniform Trust Code broadens a court's ability to apply "equitable deviation" to terminate or modify trusts.²⁵ The purpose of "equitable deviation" is not to disregard the settlor's intent but to modify inopportune details to better effectuate the settlor's broader purposes.²⁶ As with Section 411, Section 412

²⁰ See *id.*

²¹ See *id.*

²² See *id.*

²³ See *id.*

²⁴ See *id.*

²⁵ See UNIF. TRUST CODE § 412 (amended 2004) commentary.

²⁶ See *id.*

incorporates similar provisions in the Restatement (Third) of Trusts.²⁷ This Section states:

(a) The court may modify the administrative or dispositive terms of a trust or terminate the trust if, because of circumstances not anticipated by the settlor, modification or termination will further the purposes of the trust. To the extent practicable, the modification must be made in accordance with the settlor's probable intention.

(b) The court may modify the administrative terms of a trust if continuation of the trust on its existing terms would be impracticable or wasteful or impair the trust's administration.

(c) Upon termination of a trust under this section, the trustee shall distribute the trust property in a manner consistent with the purposes of the trust.

See Uniform Trust Code § 412.

Subsection (a) allows a court to modify the dispositive provisions of the trust as well as its administrative terms; subsection (b) broadens the court's ability to modify the administrative terms of a trust.²⁸

Section 412 of the Uniform Trust Code has parallels in Sections 112.054(a)(3)-(4), which allow for modification of a trust's administrative, nondispositive terms if necessary or appropriate to prevent waste or avoid impairment of trust administration, and/or because of a change in circumstances not known to or anticipated by the settlor (and such order will further the purposes of the trust).

C. Uniform Trust Code Section 416

Section 416 of the Uniform Trust Code allows modification of a trust to achieve the settlor's tax objectives and states:

“To achieve the settlor's tax objectives, the court may modify the terms of a trust in a manner that is not contrary to the settlor's probable intention. The court may provide that the modification has retroactive effect.”

²⁷ See *id.*; see also RESTATEMENT (THIRD) OF TRUSTS § 66(1), 27(2) & cmt. B (requiring that a trust and its terms be for the benefit of its beneficiaries).

²⁸ See *id.*

See Uniform Trust Code § 416.

This section is copied from Restatement (Third) of Property,²⁹ which allows the terms of a trust to be changed to meet a settlor's tax-saving objective as long as the resulting terms, particularly the dispositive provisions, are not inconsistent with the settlor's probable intent.³⁰ The modification allowed by this subsection is similar in concept to the *cy-pres* doctrine for charitable trusts.³¹

Section 416 of the Uniform Trust Code is nearly identical to Section 112.054(a)(4) of the Texas statute, which allows for modification if "necessary or appropriate to achieve the settlor's tax objectives and is not contrary to the settlor's intentions."

V. Practical Applications of Section 112.054

The amended, liberalized statute provides the practitioner (or the party seeking relief) with a number of new, flexible, and effective tools for modifying trusts to meet the needs of a trust's beneficiaries, while still honoring a settlor's intent.

Consider the application of the new Texas Trust Code provisions to the following hypothetical scenarios set forth in the Restatement (Third) of Trusts:

1. S left his estate to T as trustee with a direction to pay the trust income to L for life and, upon her death, to terminate the trust and distribute the remainder to R if then living and if not then to R's issue. Some years after S's death, L encountered a series of health problems that will result in major medical expenses and require expensive care over the rest of her lifetime. It appears from the circumstances and other evidence bearing on the planning of S's estate that L was the primary object of his bounty, but that, given the size of the trust estate, S anticipated that L could live comfortably on its income or even a part thereof.³²

²⁹ See RESTATEMENT (THIRD) OF PROPERTY § 12.2 (Tentative Draft No. 1, approved 1995).

³⁰ See UNIF. TRUST CODE § 416 (amended 2004) commentary.

³¹ See UNIF. TRUST CODE § 416 (amended 2004) commentary.

³² See RESTATEMENT (THIRD) OF TRUSTS § 66 illus. 2.

Although the terms of the trust do not authorize T to invade principal, the court might modify the trust in accordance with Section 112.054(a) of the Texas Property Code to enable T to do so as necessary to meet L's additional needs, the rationale being that such an order would further the purposes of the trust (health, support, and maintenance of L).

2. S devised a portion of his estate to T as trustee, "to apply such amounts of the trust income and principal as T deems appropriate for the education of my grandchildren, X, Y, and Z," and when the youngest of them reaches age 26, or at such earlier time as T, in her sole discretion, believes they have all completed their education," the trust is to terminate, with the trust estate then to be distributed to those grandchildren in equal shares. When the grandchildren are ages 19, 20, and 23, they ask to have the trust terminated and request T to distribute the trust property to them.³³

Although the trust terms reveal a material purpose that would appear to prevent the trust from being terminated, one could argue that the continuance of the trust is not necessary to achieve any material purpose of the trust if in T's discretion X, Y, and Z have completed their education. Termination in this instance might be permitted pursuant to Section 112.054(a)(5)(A).

3. The terms of the trust being administered by T require the retention of a modest-sized apartment complex that the settlor had owned and operated during her lifetime. It has subsequently become clear that this apartment complex cannot be administered efficiently and can be expected to detract from the overall performance of the trust estate, to the disadvantage of all of the beneficiaries.³⁴

Here, the Court might authorize deviation from the terms of the trust to enable the trustee to sell the apartment complex and reinvest the proceeds. This might prevent waste and possibly further the purposes of the trust in accordance with Sections 112.054(a)(2). If the apartment complex has become uneconomical to operate, the trust

³³ See RESTATEMENT (THIRD) OF TRUSTS § 65 illus. 6.

³⁴ See RESTATEMENT (THIRD) OF TRUSTS § 66 illus. 1.

could also be modified because this was a circumstance that obviously was not anticipated by the settlor. See Section 112.054(a)(3).

4. After the death of S, T discovered that the available trust assets totaled about \$700,000.00. Given the magnitude of the trust assets, T was concerned she would breach her fiduciary duty to the trust's remaindermen by holding this amount in trust for the sole purpose of generating \$3,600.00 per year for three elderly beneficiaries. The cost of administration of the trust would exceed this figure, and T would be open to a charge of unjust enrichment at the expense of the beneficiaries. T was also concerned that the remainder interests would not qualify for a charitable deduction because the income interests were not in one of the forms required by the Internal Revenue Service.

Here, T might petition the court under Section 112.054(a)(2) and (4) to amend the trust to allow for larger distributions to the elderly beneficiaries (their health, support, and maintenance probably being one the trust's main purpose). T might also request the court amend the trust to reform the income interests for the purpose of qualifying for the charitable deductions.

VI. Mechanics of Judicial Modification and Termination of Trusts

Generally, to judicially terminate or modify a trust, one needs to file either an original petition brought specifically under Section 112.054, or a petition for declaratory judgment under TEX. CIV. PRAC. & REM. CODE § 37.002, *et seq.*

Both district courts and statutory probate courts have jurisdiction over these kinds of actions. See TEX. PROP. CODE § 115.001, TEX. PROB. CODE § 5(e). If there is an ongoing estate or guardianship administration related to the trust, it may be in all parties' best interest to bring a modification/termination suit in the statutory probate court. An original proceeding relating to a revocable or irrevocable trust may also be brought in probate court regardless of whether a probate estate is pending. The petition should be styled "In Re [Name of Trust] and most courts will require the trust be attached as an exhibit.

Necessary parties to these actions can include: 1) beneficiaries; 2) trustees; 3) contingent beneficiaries; 4) the attorney general; 5) persons actually receiving distributions from the trust estate at the time the action is filed; and 6) any other interested person.³⁵ Parties under the age of majority (beneficiaries or contingent beneficiaries of a trust, for example) often can be represented by their parents or guardians, unless there is a conflict of interest, in which case an attorney ad litem may need to be appointed.

Fortunately in cases of this type, the parties are often cooperative and seek the same goals and outcomes. In these circumstances, it is extremely helpful to obtain waivers of notice and service. As the litigation progresses, it also is often possible to have cooperative parties sign off on an agreed judgment effecting the desired changes to the subject trust. Accordingly, if the parties can cooperate, it will save the trust and beneficiaries substantial time and money. If the trustee is the applicant for modification, he or she should encourage the beneficiaries (and any co-trustee) to retain counsel to advise them on their rights in the proceeding. Trustee's counsel should make it abundantly clear to the beneficiaries and co-trustee that counsel does not represent them and cannot advise them on the effects of the modification.³⁶

Lastly, an issue related to judicial termination and modification of trusts involves the resignation of trustees. A trustee may resign in accordance with the terms of the trust instrument; a trustee may also petition a court for permission to resign as trustee.³⁷ A

³⁵ TEX. PROP. CODE § 115.011. Contingent beneficiaries designated as a class are not necessary parties to an action brought under TEX. PROP. CODE § 115.001. As always, one should refer to the terms of the Will or trust agreement to determine if there are other necessary parties. See also TEX. R. CIV. P. 37, 39.

³⁶ See *Vinson & Elkins v. Moran*, 946 S.W.2d 381 (Tex. App. – Houston [14th Dist.] 1997, rev'd and rendered in part, rev'd and remanded in part).

³⁷ See TEX. PROP. CODE § 113.081(a). This statute follows the Restatement (Third) of Trusts, which allows for the resignation of trustees if the resignation is made: 1) in accordance with the terms of the trust; 2) with

court may accept a trustee's resignation and discharge the trustee from the trust on the terms and conditions necessary to protect the rights of other interested persons.³⁸ To effect the resignation, it may or may not be necessary to modify the terms of the trust. As a practical matter, a corporate trustee should not appoint its successor, even if allowed by the terms of the trust, in order to avoid exposure to liability for the selection. The beneficiaries many times select the successor or, if dissension prevents the appointment, the court can make the selection. It is also possible that a successor is not required by the terms of the trust if there is a co-trustee that is allowed to serve as the sole trustee.

The practitioner must be sure the successor will accept the trustee duties. There have been occasions where parties assure counsel and the court that a specific corporate trustee or an individual trustee will serve only to find out after the judgment is signed that the role has been refused. This necessitates an amended judgment and a window of time without a trustee in position to manage the trust.

A trustee should always take care, however, to ask the court for a judicial discharge of all past, present or future liability or duties in any capacity for actions taken or not taken as trustee of the trust. If the trustee simply resigns without a release from the beneficiaries or an order of discharge, the trustee could face future breach of fiduciary duty claims without having access to the trust assets to defend itself.

the consent of all beneficiaries; or 3) upon terms approved by the proper court. See RESTATEMENT (THIRD) OF TRUSTS § 36. Under these provisions, the trustee's resignation becomes effective only upon the acceptance of the trusteeship by a new trustee. See RESTATEMENT (THIRD) OF TRUSTS § 65, comment a. Also, a trustee may not exercise a power of resignation or otherwise resign for the purpose of facilitating a breach of trust by any remaining co-trustees, or of escaping adverse circumstances without disclosing the breach or circumstances to the beneficiaries, settlor, or court. See *id.* All trustee powers, including resignation, are subject to an exercise of good faith. See generally RESTATEMENT (THIRD) OF TRUSTS §§ 70, 76-78, 187.

³⁸ See TEX. PROP. CODE § 113.081(b).

The successor trustee should also be involved in the preparation of the judgment appointing it. Most corporate trustees have specific language they require in a judgment before taking over the fiduciary role. For example, the successor might require language in the judgment relieving it from the duty of examining the acts of the resigning trustee.

VII. Conclusion

The recent changes to Section 112.054 of the Texas Property Code make it much easier to petition the court to modify a trust's terms, or terminate the trust altogether. The liberalized rules can be used to serve a beneficiary's best interest, and the greater flexibility can aid in the achievement of a settlor's objectives and purposes in creating the trust.