Asset Concentrations And The Duty To Diversify

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I. Introduction

Being a trustee is becoming an ever more complicated job. One of the most important issues that a trustee faces is the decision to diversify assets. This is especially an important issue in Texas. Texans have heard for generations that you never sell oil and gas interests. Texans also have family businesses, ranches, and other real property and would never want to part with those assets. That is true even if those assets make up most of the value of a trust.

Corporate trustees are placed under intense internal and external pressure to diversify trust assets. Local trust administrators may be ordered to sell the family farm, oil and gas interests, or the family business, so that they can liquate that investment and place the funds in other investments to spread around the risk. In addition to being very unpopular with beneficiaries for emotional reasons, this may also directly impact income beneficiaries in principal-versus-interest allocations, e.g., income from oil and gas interests or the family business that used to be distributed to the income beneficiary may decrease due to the new investments being more growth oriented.

Diversification also does not always end up with the best financial results: "It is equally important to understand that diversification is a double-edged sword. Depending on the markets, or the assets in question, a well-diversified portfolio may underperform or overperform a concentrated asset by a significant magnitude." Jochen Vogler, *Why Diversify?*, www.step.org/journal (January 2015).

The trustee finds itself in a catch twenty two situation where there may be two forces at work. Some or all of the beneficiaries may demand that the trustee not diversify. Regulators may suggest diversification. What is a trustee to do?

II. History Of The Duty To Diversify

The law of trusts originated in equity to evade the strictness of the common law. It was a part of property law where one person held legal title to assets and another held the equitable title. William Sanders, *Resolving The Conflict Between Fiduciary Duties and Socially Responsible Investing*, 35 PACE L. REV. 535, 546-47 (2014). The person holding legal title held it for the benefit of the equitable title holders. *Id*. Some say that trusts originated in the times of the crusades when English lords went off to fight and left their feudal lands in the care of others. It was also used to circumvent the feudal restrictions on land transfer where landowners could not transfer their land by will due to primogeniture (the common law right of the firstborn son to inherit his ancestor's estate to the exclusion of younger siblings). *Id*. Rather than allowing a death to trigger the land-transfer laws, landowners could convey their land into a trust during life, and the trustee would then transfer the land to the chosen beneficiary after the original owner's death. *Id*. "The trustee's only duty in those days was to convey the land." *Id*. Therefore, legal title holders

were not supposed to diversify; rather, they were supposed to maintain the lands. Trustees were not paid and did not do much day-to-day work caring for the trust assets.

The concept of diversification did not occur until much later. Eventually, more people used trusts for a larger variety of purposes. People started using trusts to assist in retirement planning and caring for individuals who were deemed insufficiently sophisticated to invest and maintain their inheritance. *Id*. Trustees had to do more work to care for the assets and were compensated accordingly. "The modern-day trustee's job is to actively manage trust assets. Active management means the contemporary trustee, unlike the ancient trustee, has discretion over those assets." *Id*.

In the early 1830s, one of the first definitions of a fiduciary initiated a "prudent man" standard. *Harvard College v. Armory*, 26 Mass. (9 Pick) 446 (1830). Under that standard, a trustee "is to 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." *Id*. The "prudent man" standard emphasized the preservation of trust principal. A trustee could be surcharged if an individual asset lost value even if the overall portfolio increased in value. Trustees were accordingly very conservative in investing because they could be judged on an asset-by-asset basis and not on how the entire portfolio performed.

Today, most jurisdictions use a "prudent investor" standard. In 2004, forty-eight states adopted the Uniform Prudent Investor Act, Texas being one of those jurisdictions. Some of the advances reflects a modern portfolio theory that focuses on the importance of reviewing the entirety of a trust's assets, rather than individual investments, when judging a trustee's investment results. Jochen Vogler, *Why Diversify?*, www.step.org/journal (January 2015). Under this uniform act, diversification is expressly required unless an exception is present. *Id.* No investment categories or types of assets are imprudent per se; a trustee should judge the suitability of the investment for the purposes and needs of the trust and its beneficiaries. *Id.* It is a more modern approach to trust investments where the trustee's main goal is to balance acceptable risk with—hopefully—increased returns based on the purposes and goals of the trust and its beneficiaries.

III. What Is Diversification?

One commentator has defined diversification as:

> A portfolio strategy designed to reduce exposure to risk by combining a variety of investments, such as stocks, bonds, and real estate, which are unlikely to all move in the same direction. The goal of diversification is to reduce the risk in a portfolio. Volatility is limited by the fact that not all asset classes or industries or individual companies move up and down in value at the same time or at the same rate. Diversification reduces both the

> upside and downside potential and allows for more consistent performance under a wide range of economic conditions.

http://www.investorwords.com/1504/diversification

Texas law does not spell out a black and white standard or formula for diversification; indeed, the Uniform Prudent Investor Act and its comments do not state what should be a prudent trustee's asset allocation. Tex. Prop. Code Ann. § 117.005. Rather, the comments say: "There is no automatic rule for identifying how much diversification is enough. The 1992 Restatement says: 'Significant diversification advantages can be achieved with a small number of well-selected securities representing different industries … Broader diversification is usually to be preferred in trust investing…" *Id*. cmt. The only Texas case addressing a diversification issue indicated that 100% of the trust should not be invested in a single company's stock. *Jewett v. Capital Nat'l Bank*, 618 S.W.2d 109 (Tex. Civ. App.—Waco 1981, writ ref'd n.r.e.). That is rather self-evident and not particularly helpful.

A court in another jurisdiction held that a trustee should diversify where a trust's portfolio contains a concentration of forty percent or more in one stock. *See, e.g., In re Williams*, 591 N.W.2d 743 (Minn. App. 1999), *aff'd in part and rev'd in part*, 631 N.W.2d 398 (Minn. 2001). Another court determined the damages from a trustee's failure to diversify by reviewing what the portfolio would have performed if the non-diversified stock had been brought down to five percent of the portfolio. *Will of Dumont*, 791 N.Y.S.2d 868 (N.Y. Sur. 2004). That would tend to indicate that a trustee can invest up to five percent of a trust's portfolio in a single company's stock and comply with a duty to diversify. *Id*. Of course diversification also applies to non-security assets. *See Green v. Lombard*, 343 A.2d 905 (Md. App. 1975) (trustee breached duty by investing sixty one percent of trust in mortgages); *Estate of Collins*, 72 Cal. App. 3d 663, 139 Cal. Rptr. 644 (1977) (trustee breached duty by investing two thirds of the trust in one asset). One court has recently held that a trustee breached the duty to diversify by failing to protect the principal against inflation. *The Woodward School for Girls, Inc. v. City of Quincy*, 13 N.E.3d 579 (Mass. 2014).

Rightfully so, lawyers and judges should not be in the business of giving financial advice. Lawyers are not always the best business people. Rather, financial advisors and investment professionals are the right people to determine what an appropriate diversification plan should be. That will likely depend upon the trust, the trustee, the beneficiaries, etc. No one plan fits all. There should be a review of all levels of portfolio diversification, including: asset classes, liquidity, currencies, regions, jurisdictions, and investment styles. Jochen Vogler, *Why Diversify?*, www.step.org/journal (January 2015). The implementation of a client-specific diversified portfolio may mean a regular review of these factors. Another commentator has stated:

> [I]nvestors should acquire investments that have negative or low correlations to each other. By purchasing assets with negative or low correlations to each other, an investor can substantially reduce the risk associated with a specific investment. Diversification thus involves much more than buying stocks in two companies versus only holding stock in one company. It involves purchasing stocks, bonds, hedge funds, commodities, and other investments in a manner to reduce the "diversifiable risk" of investing in a single asset or single class of assets.

Trent S. Kiziah, *The Trustee's Duty to Diversify: An Examination of The Developing Caselaw*, 36 ACTEC L. J. 357, 359 (2010). The market compensates a trust for "compensated risk," which is the "risk associated with fluctuating interest rates, inflation, exchange rates and general market conditions." *Id*. However, a trust receives no compensation for retaining a concentration of assets. *Id*. A trustee should attempt to limit uncompensated risk. *Id*. "Failure to diversify on a reasonable basis in order to reduce uncompensated risk is ordinarily a violation of both the duties of care and skill." *Id*. (quoting RESTATEMENT (THIRD) OF TRUSTS, § 90 cmt. e(1)).

"Significant diversification advantages can be achieved with a modest number of well-selected securities representing different industries and having differences in their qualities. Broader diversification, however, is usually to be preferred in trust investing." RESTATEMENT (THIRD) OF TRUSTS, § 90 cmt. g. The Restatement goes on to state:

> There is no defined set of asset categories to be considered by fiduciary investors. Nor does a trustee's general duty to diversify investments assume that all basic categories are to be represented in a trust's portfolio. In fact, given the variety of defensible investment strategies and the wide variations in trust purposes, terms, obligations, and other circumstances, diversification concerns do not necessarily preclude an asset-allocation plan that emphasizes a single category of investments as long as the requirements of both caution and impartiality are accommodated in a manner suitable to the objectives of the particular trust.

Id. Further, to maximize the return of the trust, a trustee also has a duty to avoid unnecessary costs, including investment expenses and inflation risk, and to consider the tax consequences of any transaction. Generally, trust funds must be segregated and kept separate. However, small trusts incur larger transaction costs and fees and the modern trend has been to allow trustees to merge small trust funds together to lower the transaction costs and allow for greater diversification of a merged portfolio.

If there is litigation, this means that the parties will likely need to retain financial experts to provide opinions on whether a trustee's diversification plan was sufficient considering all relevant factors. *See Berlinger v. Wells Fargo, N.A.*, 2015 U.S. Dist. LEXIS 141111, *27-30 (M.D. Fla. October 16, 2015) (summary judgment on failure to diversify claim

was denied where a fact issue was created by competing expert reports). For example, in *In re Estate of Maxedon*, a beneficiary sued a corporate trustee for breaching fiduciary duties based on a failure to diversify. 24 Kan. App. 2d 427, 946 P.2d 104 (1997). The trustee offered expert evidence showing that it did diversify trust assets by maintaining oil and gas assets in the trust:

> [T]he Bank presented the testimony of W. Newton Male, a former State Banking Commissioner, who during his tenure set up the state trust examiners' system. Male also had worked in his spare time appraising farms in and around Wichita. Male testified that the fact the farmland was spread out over three counties and consisted of tillable land as well as pasture, plus the fact there was oil and gas production on some of the property, showed the trust was in fact diversified. While Male did not testify as to what the standard of care was, it was his opinion that the Bank did not breach its duty of care in managing the assets of the trust. Our review of the record convinces us the beneficiaries failed to present competent testimony of the trustee's standard of care and how the trustee's actions violated that standard of care. Conversely, the Bank did present competent testimony that indicated that the Bank's actions did not breach the applicable standard of care.

Id. at 439. Further, a trial court should not interfere with a trustee's discretion even if it disagrees with an investment plan. *See In re Mark Anthony Fowler Special Needs Trust*, 2011 Wash. App. LEXIS 358 (Wash. Ct. App. February 8, 2011) (court of appeals reversed a trial court's order to a trustee to change an investment plan where the trial court failed to find that the trustee had breached a duty).

IV. Common-Law Duty To Diversify

Before codes, statutes, and uniform standards, trustees' duties were determined by the common law. Based on the parties' arguments and case precedents, judges determined what duties a trustee owed to diversify.

A trustee is a fiduciary and is held to a high standard of care in dealing with the trust property. A trustee owes to his beneficiaries an unwavering duty of good faith, fair dealing, loyalty, and fidelity over the affairs of the trust and its corpus. *See Herschbach v. City of Corpus Christi*, 883 S.W.2d 720, 735 (Tex. App.—Corpus Christi 1994, writ denied); *Interfirst Bank Dallas, N.A. v. Risser*, 739 S.W.2d 882, 888 (Tex. App.—Texarkana 1987, no writ). "A trustee's fundamental duties include the use of the skill and prudence which an ordinary, capable, and careful person will use in the conduct of his own affairs as well as loyalty to the trust's beneficiaries." *Herschbach,* 883 S.W.2d at 735. Trustees who hold themselves out as having special expertise in the area of finance and investments must use this expertise in managing their trusts. *See* RESTATEMENT (THIRD) OF TRUSTS § 90 cmt. d (2007) ("If the trustee possesses a degree of skill greater

than that of an individual of ordinary intelligence, the trustee is liable for a loss that results from failure to make reasonably diligent use of that skill."). "The duty of care requires the trustee to exercise reasonable effort and diligence in making and monitoring investments for the trust, with attention to the trust's objectives." *Id*. at cmt. d.

"One of the basic duties of a trustee is to make the assets of the trust productive while at the same time preserving the assets." *Neuhaus v. Richards*, 846 S.W.2d 70 (Tex. App.—Corpus Christi 1992, no writ). "A trustee is under a duty to the beneficiary except as otherwise provided by the terms of the trust, to distribute the risk of loss by a reasonable diversification of investments, unless under the circumstances it is prudent not to do so." *Jewett v. Capital Nat'l Bank*, 618 S.W.2d 109 (Tex. Civ. App.—Waco 1981, no writ).

Restatement (Second) of Trusts § 231 (1959) states that "except as otherwise provided by the terms of the trust, if the trustee holds property which when acquired by him was a proper investment, but which thereafter becomes an investment which would not be a proper investment for the trustee to make, it becomes the duty of the trustee to the beneficiary to dispose of the property within a reasonable time." RESTATEMENT (SECOND) OF TRUSTS § 228 (1959) (recognizing that trustee has duty to diversify). Texas courts routinely rely on the Restatement of Trusts as authority for trust issues. *See, e.g., Highland Homes Ltd. v. State*, 448 S.W.3d 403, n. 9 (Tex. 2014); *ERI Consulting Eng'rs, Inc. v. Swinnea*, 318 S.W.3d 867 (Tex. 2010); *Burrow v. Arce*, 997 S.W.2d 229 (Tex. 1999); *Foshee v. Republic Nat'l Bank*, 617 S.W.2d 675, 677 (Tex. 1981); *Powers v. First Nat. Bank of Corsicana*, 138 Tex. 604, 161 S.W.2d 273, 279 (Tex. 1942). Accordingly, though not precisely defined, there is generally a common-law duty to diversify in Texas unless under the circumstances it is prudent not to do so or the trust document otherwise states.

In a similar area of law, the custodian of a discretionary investment account has to meet a high duty of care. *See Anton v. Merrill Lynch*, 36 S.W.3d 251, (Tex. App.—Austin 2001, pet. denied). In *Anton*, the court described these duties as:

> (1) manage the account in a manner directly comporting with the needs and objectives of the customer as stated in the authorization papers or as apparent from the customer's investment and trading history; (2) keep informed regarding the changes in the market which affect his customer's interest and act responsively to protect those interests; (3) keep his customer informed as to each completed transaction; and (4) explain forthrightly the practical impact and potential risks of the course of dealing in which the broker is engaged.

Id. at 257-58 (citing *Leib v. Merrill Lynch, Pierce, Fenner & Smith, Inc*., 461 F. Supp. 951 (E.D. Mich. 1978), *aff'd* 647 F.2d 165 (6th Cir. 1981); *McCoun v. Rea (In re Rea)*, 245 B.R. 77, 90 (Bankr. N. D. Tex. 2000) (outlining duties of Texan who day-traded stocks using adversary plaintiffs' money)).

Courts in other states also agree that there is generally a common-law duty to diversify. This duty to diversify is not absolute, and a court should view that duty in conjunction with the trust document and the settlor's intent. *Shriners Hosps. for Children v. First Northern Bank of Wyo.*, 373 P.3d 392 (S. Ct. Wyo. 2016) (trustee did not breach a fiduciary duty of diversification by refusing to sale ranch asset).

V. Statutory Duty To Diversify

A. Trust Code Adopts Common Law

Unless the terms of the trust provide otherwise, the Texas Trust Code governs the duties and powers of a trustee, relations among trustees, and the rights and interests of a beneficiary. Tex. Prop. Code Ann. § 111.0035(a). The Texas Trust Code expressly adopts a trustee's common-law duties: "The trustee shall administer the trust in good faith according to its terms and this subtitle. In the absence of any contrary terms in the trust instrument or contrary provisions of this subtitle, in administering the trust the trustee shall perform all of the duties imposed on trustees by the common law." Tex. Prop. Code Ann. § 113.051. Therefore, absent a contrary term in the Texas Trust Code or the trust instrument, the trustee will have a duty to diversify as per the common-law requirement.

The Texas Trust Code historically did not expressly require any diversification of trust assets. Rather, the Code expressly stated that a trustee had no duty to diversify any assets originally conveyed to the trust by the settlor. *See* former Tex. Prop. Code Ann § 113.003 (repealed effective January 1, 2004) ("A trustee may retain, without regard to diversification of investments and without liability for any depreciation or loss resulting from the retention, any property that constitutes the initial trust corpus or that is added to the trust."). Many trusts in Texas had clauses that followed the language of this statutory provision.

In *Shands v. Texas State Bank*, beneficiaries sued an agent of the executor for not funding a trust and then not investing or diversifying the assets appropriately. No. 04-00-00133-CV, 2001 Tex. App. LEXIS 109 (Tex. App.—San Antonio January 10, 2001, no pet.). The beneficiaries complained:

> According to Mrs. Shands, the bank, however, did little or nothing to determine Mrs. Shands's investment objectives, needs, desires, and wants with respect to the assets in the Management Trust and the Estate accounts. Mrs. Shands further contended that the bank failed to provide competent investment advice to her, instead leaving the assets invested in tax free municipal bonds, when other investment strategies would have produced greater income and growth. By leaving the Trust's assets invested in municipal bonds, Mrs. Shands complained that the bank had to invade the principal in order to pay expenses that the bank incurred, rather than changing the investment strategy to realize income and growth.

Id. at *3-4. The trial court granted summary judgment for the bank, and the beneficiary appealed that decision. The court of appeals affirmed the summary judgment. The court stated that an exculpatory clause—"no Trustee shall be liable for any act or omission except in the case of gross negligence, bad faith or fraud…"—in the will protected the bank from liability. The bank produced expert testimony explaining that it did not invest the funds because it was not directed to do so by the executor. The court of appeals held that the beneficiary did not controvert this evidence and affirmed the summary judgment:

> Even though Campbell asserted in her affidavit that the bank breached its fiduciary duty by leaving the assets of the trust and the estate in municipal bonds and should have invested the funds in a different manner, her testimony did not controvert the bank's basis for not moving the funds; namely, the bank did not have the authority to close the Estate of P.C. Shands and fund the Shands Marital Trust and the P.C. Shands Family Trust.

Id. at *26-27.

B. Uniform Prudent Investor Act

The Texas Legislature (along with 48 other states) adopted the Uniform Prudent Investor Act effective January 1, 2004, and the Texas Trust Code now expressly discusses the concept of a duty to diversify. Subject to Chapter 117 (The Uniform Prudent Investor Act), a trustee may manage trust property and invest and reinvest in property of any character on the conditions and for the lengths of time as the trustee considers proper. Tex. Prop. Code Ann. § 113.006. Chapter 117 is the limitation on this rather broad grant of authority. It provides that a trustee who invests and manages trust assets owes a duty to the beneficiaries to comply with the prudent investor rule. Tex. Prop. Code Ann. § 117.003(a). Under the statute, the prudent investor rule provides:

> (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) Except as otherwise provided by and subject to this subtitle, a trustee may invest in any kind of property or type of investment consistent with the standards of this chapter.
>
> (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.

Tex. Prop. Code Ann. § 117.004; *see also Barrientos v. Nava,* 94 S.W.3d 270, 282 (Tex. App.—Houston [14th Dist.] 2002, no pet.).

This duty to diversify starts as soon as the trustee takes control over the trust's assets. "Within a reasonable time after accepting a trusteeship or receiving trust assets, a trustee shall review the trust assets and make and implement decisions concerning the retention and disposition of assets, in order to bring the trust portfolio into compliance with the purposes, terms, distribution requirements, and other circumstances of the trust, and with the requirements of this chapter." Tex. Prop. Code Ann. § 117.006. *Langford v. Shamburger*, 417 S.W.2d 438, 444-45 (Tex. Civ. App.—Fort Worth 1967, writ ref'd n.r.e.) (the trustee should "put trust funds to productive use and the failure to do so within a reasonable period of time can render the trustee personally chargeable with interest."). A trustee can incur liability for not timely diversifying assets. *See, e.g., Fifth Third Bank v. Firstar Bank, N.A.,* 2006 Ohio 4506 (Ohio App. 1st Div. 2006) (trustee's plan to liquidate stock over twelve month period was too long); *Williams v. JPMorgan & Co. Inc.*, 199 F.Supp.2d 189 (S.D.N.Y. 2002) (trustee liquidated assets due to initial concern and invested in municipal bonds for thirty years).

"The recurring theme provided in case law is that in the absence of specific direction in the trust instrument, a trustee's 'reasonable determination' depends on the actual investment plan implemented and carried out by the trustee in light of the needs of the particular beneficiaries and the particular trust portfolio involved." Elliot & Bennett, *Closely Held Business Interests and the Trustee's Duty To Diversify,* TRUSTS & ESTATES, trustsandestates.com (April 2009). "This requires the trustee to develop an investment

strategy tailored to the factual circumstances surrounding the trust's purpose and to evaluate the income needs of the beneficiaries. The failure to communicate with the beneficiaries or exercise any discretion at all potentially subjects the trustee to liability for failure to diversify." *Id*. The first and most important step is determining the needs of the beneficiaries. *See First Alabama Bank of Huntsville, N.A. v. Spragins*, 515 So.2d 962 (Ala. 1987).

C. "Special Circumstances" That Allow Non-Diversification

The Act does not require diversification in all circumstances. Rather, "A trustee shall diversify the investments of the trust unless the trustee reasonably determines that, because of special circumstances, the purposes of the trust are better served without diversifying." Tex. Prop. Code Ann. § 117.005. The notes to Section 117.005 of the Texas Property Code state that prudent investing ordinarily requires diversification. Tex. Prop. Code Ann. § 117.005, cmt. "Circumstances can, however, overcome the duty to diversify. For example, if a tax-sensitive trust owns an underdiversified block of low-basis securities, the tax costs of recognizing the gain may outweigh the advantages of diversifying the holding. The wish to retain a family business is another situation in which the purposes of the trust sometimes override the conventional duty to diversify." *Id*. *see also In re Rowe*, 712 N.Y.S2d 662 (N.Y. App. Div. 2000) (tax consequences); RESTATEMENT (THIRD) TRUSTS, § 227 (1992). The Restatement provides similar language:

> [T]he trustee's decision to retain or dispose of certain assets may properly be influenced, even without trust terms expressly bearing on the decision, by the property's special relationship to some objective of the settlor that may be inferred from the circumstances, or by some special interest or value the property may have as a part of the trust estate … Examples of such property might be land used in a family farming operation, the assets or shares of a family business, or stockholdings that represent or influence control of a closely or publically held corporation.

RESTATEMENT (THIRD) TRUSTS, § 92 (1992).

These examples are not the only circumstances and are intended to not be all inclusive. Other circumstances may include: personal property with a special attachment by the settlor or beneficiaries; maintaining a farm or ranch property; maintaining residential or vacation property; life insurance policies; stock in a company where the settlor had long-term employment or other special relationship; commercial real property where the settlor had long-term special relationship; special purpose trusts; and assets that are difficult to sell. Trent S. Kiziah, *The Trustee's Duty to Diversify: An Examination of The Developing Caselaw*, 36 ACTEC L. J. 357, 370-78 (2010).

One of the main factors that trustees must consider in determining to not diversify is whether that approach is consistent with "an asset's special relationship or special value, if any, to the purposes of the trust or to one or more of the beneficiaries." Tex. Prop. Code Ann. § 117.004. For example, courts have held that this provision protects a trustee from claims arising out of the retention of a family business. *Bank One Trust Co., N.A. v. Scherer*, 2012 Ohio App. LEXIS 4631 (Ohio Ct. App. November 15, 2012); *In re Hyde*, 845 N.Y.S.2d 833 (App. Div. 2007). In *Hyde*, three trusts owned large concentrations of a closely held business. 845 N.Y.S.2d 833. The trust document gave the trustee broad discretion in investing but did not limit the duty to diversify. *Id*. When the trustees were challenged under the prudent investor rule, the court looked to the special circumstances at play. *Id*. Specifically, the court looked to the large capital gains that a sale would create and the gridlock in management. *Id*. The special relationship inquiry can also apply to a trustee's decision to not diversify a large investment in stock. *Wood*, 828 N.E.2d 1072.

Further, the special relationship factor can justify a trustee's failure to diversify a family farm. In *In re Trust Created by Inman*, a court ruled that a trustee could not diversify a farm held in trust by selling a portion of it due to the relationship of the beneficiaries to the farm. 693 N.W.2d 514 (Neb. 2005). The court of appeals affirmed this holding, stating:

> [T]he trustee's statutory duty to diversify trust assets is subject to the general "prudent investor" standard of care which requires a trustee to consider various circumstances relevant to the trust or its beneficiaries in investing and managing trust assets. These circumstances include "an asset's special relationship or special value, if any, to the purposes of the trust or to one or more of the beneficiaries." We agree with a commentator who has noted that a similar provision in the Nebraska Uniform Prudent Investor Act could be utilized as a basis for justifying "non-diversification" of a family farm or ranch held in trust in favor of retaining the asset "for future generations of the family." Brackett's professed "sentimental" attachment to the farmland which has been in his family for many years is clearly shared by the other family members who are beneficiaries of the trust. Those who filed an objection or testified in opposition to the proposed sale expressed the view that excising a 42-acre parcel from the 189-acre farm would have a detrimental effect upon their special relationship with the asset without achieving any appreciable benefit.

Id. at 520-21 (internal citations omitted). Further, the held that the trustee did not offer evidence to support a need to diversify or the benefit of such diversification:

> Brackett presented no specific plan for investment of the proceeds from the proposed sale, and thus, any potential benefit to the beneficiaries in the nature of increased income without a corresponding increase in risk to the principal is speculative. There is no evidence that additional income is

> needed in order to carry out any specific purpose of the trust, and the beneficiaries have articulated a legitimate interest in maintaining the geographic integrity of the farm that has been in their family for many years.

Id. at 521-22.

In *Shriners Hosps. for Children v. First Northern Bank of Wyo.*, the settlors placed a large family farm in a trust. 373 P.3d 392 (S. Ct. Wyo. 2016). Later, a charitable beneficiary wanted the trustee to terminate the trust and distribute the assets and also sued the trustee for not diversifying the trust's assets. The court of appeals held that the trustee did not breach a duty by not diversifying the asset:

> Shriners' argument in support of this claim focuses solely on the rate of return the Trust earns by retention of the ranch and once again disregards entirely the Trust terms and the settlor's intent, contrary to our rules of interpreting and enforcing trusts. As we discussed above, one of the Trust's material purposes is retention of the ranch until the year 2100, and the Trust specifically subordinates the beneficiaries' income distributions to maintenance of the ranch. The beneficiaries' dissatisfaction with the income distributions does not provide a basis to override the settlor's intent. As we explained in American Nat'l Bank: "It must be remembered that the grantor placed these assets in the trust, and did not distribute them directly to the beneficiaries. While the assets remain in the trust, the Trustee has an obligation to the trust and the grantor as well as to the beneficiaries." American Nat'l Bank, 899 P.2d at 1341. The trustee's obligation to diversify trust investments is not an obligation to be enforced in a vacuum, without regard to the settlor's intent. As the district court observed: "Finally, if it had been the Settlors' intention to benefit the charities over any other purpose, they could have included a provision, which outright donated the Ranch, restriction free, to Shriners and Kalif upon their deaths. However, they did not do so. They crafted provisions aligned with their desire to keep the ranch open, with any net income earned after the expenses to maintain the ranch had been paid, going to Shriners and Kalif." We find no error in the district court's conclusion that First Northern Bank did not breach a fiduciary duty to diversify trust investments by rejecting Shriners' demands to sell the ranch or terminate the Trust.

Id. So, even if the trust document does not limit a duty to diversify, a trustee can properly make the decision to not diversify based on special circumstances.

PRACTICE TIP: The trustee should actively document all of the following: the decision to not diversify; the facts and circumstances that justify the decision, the settlor's intent regarding same; communications informing the beneficiaries of the

decision and the impact that it may have on the trust's portfolio; the beneficiary's knowledge, acceptance, and agreement in that decision; and regular re-evaluations of the decision.

VI. Non-Diversification Due To The Terms of The Trust

If the trust document requires that the trustee not diversify assets or permits the trustee to not diversify assets, the question arises whether such a term is enforceable in Texas.

A. Texas Law

Generally, a trust document's terms govern, and a trustee should follow them. Tex. Prop. Code Ann §§ 111.0035(b), 113.001; RESTATEMENT (THIRD) OF TRUSTS § 76(1) (2007) ("The trustee has a duty to administer the trust … in accordance with the terms of the trust . . . ."); RESTATEMENT (SECOND) OF TRUSTS § 164(a) (1959). "The trustee shall administer the trust in good faith *according to its terms* and the Texas Trust Code." *Tolar v. Tolar*, No. 12-14-00228-CV, 2015 Tex. App. LEXIS 5119 (Tex. App.—Tyler May 20, 2015, no pet.) (emphasis added). "The nature and extent of a trustee's duties and powers are primarily determined by the terms of the trust." RESTATEMENT (THIRD) OF TRUSTS § 90 cmt. B; *Stewart v. Selder*, 473 S.W.2d 3 (Tex. 1971); *Beaty v. Bales*, 677 S.W.2d 750, 754 (Tex. App.—San Antonio 1984, no writ). If the language of the trust instrument unambiguously expresses the intent of the settlor, the instrument itself confers the trustee's powers and neither the trustee nor the courts may alter those powers. *See Jewett v. Capital National Bank of Austin*, 618 S.W.2d 109, 112 (Tex. Civ. App.—Waco 1981, writ ref'd n.r.e.); *Corpus Christi National Bank v. Gerdes*, 551 S.W.2d 521, 523 (Tex. Civ. App.—Corpus Christi 1977, writ ref'd n.r.e.). However, exculpatory clauses are strictly construed, and the trustee is relieved of liability only to the extent that the trust instrument clearly provides that he shall be excused. *Jewett*, 618 S.W.2d at 112.

The Texas Trust Code expressly provides that the prudent investor rule may be expanded, restricted, eliminated, or otherwise altered by the provisions of a trust. Tex. Prop. Code Ann. § 117.003(b). "A trustee is not liable to a beneficiary to the extent that the trustee acted in *reasonable reliance* on the provisions of the trust." *Id*. (emphasis added). The concept of "reasonable reliance" on the trust's terms is discussed in more detail below. A Texas commentator has stated that this provision would seem to indicate that if a trust allows a trustee to retain assets or abrogates any duty to diversify, then a trustee may reasonably rely on that term of the trust. *See* Mary C. Burdette, *Fiduciary Duties Within Fiduciary Duties, State Bar of Texas, Trust Owning Stock in a Closely–Held Corporation*, Advanced Estate Planning and Probate (2012) ("A settlor may relieve the trustee of certain duties, restrictions, and liabilities imposed by statute.).

Further, an express term of a trust relieving a trustee of the duty to diversify may also be considered an exculpatory clause. Exculpatory clauses are also discussed in more detail below. Generally, the terms of a trust prevail over any provision of the Texas Trust Code,

except that a trust may not limit a trustee's duty to act in good faith and in accordance with the purposes of the trust. Tex. Prop. Code Ann. § 111.0035(b)(4)(B). Further, any term relieving a trustee of liability for a breach of trust committed in bad faith, intentionally, or with reckless indifference or for any profit derived by the trustee from the breach will not be enforceable. Tex. Prop. Code Ann. § 114.007(a); *Martin v. Martin*, 363 S.W.3d 221, 223-24 (Tex. App.—Texarkana 2012, pet. granted, judgm't vacated w.r.m.) (court affirmed a jury's finding of breach of fiduciary duty by a trustee and did not enforce the terms of an exculpatory clause due to statutory limitation of same). Otherwise, a settlor may relieve a trustee from a duty or restriction imposed by the Texas Property Code or common law as well as direct or permit a trustee to do or not do an action that would otherwise violate a duty or restriction imposed by the Texas Property Code or common law. Tex. Prop. Code Ann. § 114.007(c). Exculpatory clauses are strictly construed, and a person is relieved of liability only to the extent to which it is clearly provided that he shall be excused. *Jewett v. Capital Nat. Bank of Austin*, 618 S.W.2d 109, 112 (Tex. Civ. App.—Waco 1981, writ ref'd n.r.e.).

Before the Uniform Prudent Investor Act, several Texas cases discussed the enforceability of clauses allowing a trustee to retain assets and not diversify. For example, in *Jewett*, a trust held stock when it was funded, and subsequently the stock decreased in value until the trust was eventually terminated. *Jewett v. Capital Nat'l Bank*, 618 S.W.2d at 109. The trustee did nothing to manage the trust and never sold the stock, reinvested any portion of the stock, or otherwise pursued other avenues of investment. The beneficiaries sued the trustee for breach of fiduciary duty, and the trustee filed a motion for summary judgment and claimed that the trust instrument contained an exculpatory clause that relieved the trustee from any liability due to its administration of the trust. The trust instrument gave the trustee the power to invest in assets "even though they may be of a speculative nature" and that the trustee was "hereby relieved of all liability for any loss of the trust funds resulting from the investment and re-investment of the trust funds in any speculative business or venture." *Id*. at 110. The trial court granted the motion, but the court of appeals reversed. The court of appeals held that an issue of fact existed as to whether the trustee's failure to take any action to manage the trust constituted negligence and a possible breach of its fiduciary duty. The court held that "exculpatory clauses are strictly construed, and the trustee is relieved of liability only to the extent to which it is clearly provided that he shall be excused." *Id*. at 112. The court also held that "a trustee is under a duty to the beneficiary except as otherwise provided by the terms of the trust, to distribute the risk of loss by a reasonable diversification of investments, unless under the circumstances it is prudent not to do so." *Id*. The court concluded: "while the trustee was relieved from liability from investing in stocks of a speculative nature 'which promise to yield the greatest return and result in maximum appreciation of capital', it was not relieved of its negligence in failing to review the trust periodically and was not relieved of its negligence in failing to diversify the corpus of the trust." *Id*. Because of the phrasing of the trust's exculpatory clause and the trustee's

failure to do anything to diversify the trust, the court held that there was a fact question as to whether the trustee's conduct was negligent and a breach of fiduciary duty.

In *Neuhaus v. Richards*, beneficiaries sued the trustee for failing to diversify trust assets by retaining stock in the trust. 846 S.W.2d 70, 74 (Tex. App.—Corpus Christi 1992), *judgment set aside without reference to merits to effect settlement agreement*, 871 S.W.2d 182 (Tex. 1994). The trial court granted summary judgment for the trustee due to language in the trust document. The first trust term provided:

> All property transferred by gift to any trust and any property acquired by the Trustees as herein provided and from time to time constituting any part of any trust shall be deemed a proper investment, and the Trustees shall be under no obligation to dispose of or convert any such property. Investments need not be diversified, may be of a wasting nature, and may be made or retained with a view to possible increase in value. The Trustees may invest and reinvest all funds available for investment or reinvestment from time to time or at such times as they may deem advisable in such investments as they are permitted to make pursuant to the terms of this indenture. They are expressly authorized to invest in non-income-earning or producing property if in their judgment the best interest of the particular trust will be served thereby. The Trustees, except as herein otherwise specifically provided, shall have as wide latitude in the selection, retention and making of investments as an individual would have in retaining or investing his own funds, and shall not be limited to nor be bound or governed by the laws or regulations of the State of Texas or any other state or country in respect of investments by trustees, except to the extent that such laws and regulations may not be waived.

The court of appeals held that this provision was ambiguous: "section V(k) leaves uncertain whether the appellees are still under a duty to prudently manage and, if need be, sell an investment that is otherwise deemed proper, and whether the obligation to dispose of assets, of which the appellees are relieved, includes the generalized duty to manage the trust prudently, or merely relieves the appellees of any specific obligation to sell a particular kind or class of investments." *Id*. In any event, the court held that "an exculpatory provision in the trust instrument is not effective to relieve the trustee of liability for action taken in bad faith or for acting intentionally adverse or with reckless indifference to the interests of the beneficiary." *Id*. Accordingly, the court held that even if the trust agreement exculpated the trustees from all liability, it could not have done so for willful misconduct or personal dishonesty. Because one of the alleged breaches of fiduciary duty was willful misconduct, the court held that summary judgment was improper because the trustees made no attempt to negate allegations of willful misconduct.

The only two cases in Texas that discuss trust provisions that impact a trustee's duty to diversify unfortunately examine language that the courts found were ambiguous or not sufficient to eliminate a duty to diversify. There is a not a case in Texas where a court held that the language was sufficient and then discussed whether such a provision should or should not be enforced.

In a similar area of law, in *Sterling Trust Co. v. Adderley*, the Texas Supreme Court remanded an issue back to the trial court due to an improper jury instruction regarding breach of fiduciary duties. 168 S.W.3d 835 (Tex. 2004). The self-directed IRA custodian-defendant was originally found to be secondarily liable for aiding a fraudulent scheme that misappropriated money from investors. The jury instruction regarding a breach of fiduciary duty was held to be improper because it was overly broad and did not account for the contractual limitations on fiduciary duties, which the Court held were allowed under Texas law. *See id*. at 847. The limiting provisions stated: "Sterling Trust has no responsibility to question any investment directions given by the individual regardless of the nature of the investment," and that "Sterling Trust is in no way responsible for providing investment advice." *Id*. Although the Texas Supreme Court did not analyze common-law duties owed by custodians, it did make clear that contractual limitations would impact duties owed between parties.

B. Mandatory Versus Permissive Language For A Trust Clause Eliminating The Duty To Diversify

Like everything else in the law, there is no definite language that will work in all circumstances: each trust is different. "As a general rule a trustee can properly make investments in such properties and in such manner as expressly or impliedly authorized by the terms of the trust." RESTATEMENT (THIRD) TRUSTS § 91, cmt. d. The terms of a trust may limit or expand a trustee's investment authority in various ways. "A trustee is not liable to a beneficiary to the extent that the trustee acted *in reasonable reliance* on the provisions of the trust." Tex. Prop. Code Ann. § 117.003(b). "The determination of the trustee's liability for non-diversification hangs on whether the reliance was 'reasonable' to overcome the trustee's general duty to diversify." Elliot & Bennett, *Closely Held Business Interests and the Trustee's Duty To Diversify*, TRUSTS & ESTATES, trustsandestates.com (April 2009). "The trustee might be entitled to rely on a general authorization to retain certain assets coupled with a provision expressly limiting the trustee's duties of prudence and diversification with respect to such assets, or by a more general investment provision specifically limiting or altering the trustee's default duties of prudence or diversification under state law." *Id*. Further, "[i]n determining the reasonableness of a trustee's adherence to provisions directing or authorizing retention of certain investments, the Restatement and courts have focused on distinctions between mandatory and discretionary provisions on both the trustee's duty and the assets to which the duty applies." *Id*.

"Mandatory" provisions limit the trustee's investment authority, usually by forbidding the retention or acquisition of certain investments, or by requiring that certain property be retained or acquired for the trust estate. RESTATEMENT (THIRD) TRUSTS § 91, cmt. e. "The 'reasonable reliance' requirement may be satisfied when a specific abrogation of the duty to diversify is made with respect to a particular investment, or when a mandatory provision directs the trustee to engage in or retain certain investments. The Restatement provides that mandatory provisions directing or restricting trust investments are legally permissible and often displace a trustee's normal duty of prudence." Elliot & Bennett, *Closely Held Business Interests and the Trustee's Duty To Diversify*, TRUSTS & ESTATES, trustsandestates.com (April 2009).

A mandatory clause states that a trustee shall not diversify and shall retain a particular asset in a trust. When a clause so states, the trustee will have to go to court to modify the trust or otherwise seek judicial assistance in diversifying. *See, e.g., In re Trusteeship of Mayo*, 105 N.W.2d 900 (Minn. 1960); *In re Pulitzer's Estate*, 249 N.Y.S. 87 (Surr. Ct. 1931). For example, such a clause may state:

> The settlor and the beneficiaries have a special relationship to the [family farm, family business, stock, etc.], and one of the main purposes of the trust is to maintain that asset and the family's relationship to it. The trustee is hereby directed to retain that asset in the trust, and the trustee will have no duty to sell or diversify that asset in any circumstance. The trustee will maintain and retain that asset in the trust even though it may be the only asset in the trust. Retaining this asset shall be proper despite any resulting risk or lack of diversification. With regard to this asset the trustee shall have no duty to invest with prudence, care, skill, and caution. The trustee shall not be liable to any party for any diminution in value of the trust that may result from retaining the asset.

As a trustee has the duty to follow the terms of the trust, this would provide the most protection for a trustee's action in not diversifying. However, the trouble with this type of provision is that if the trustee and/or beneficiaries ever want to diversify and sell the asset, they will need to go court to modify the trust. *Id*. That should not be a difficult process, but it may take some time to effectuate. A trustee should prefer a trust term that is more specific, and language that is mandatory and provides no discretion to a trustee is the safest provision. Some commentators have stated that a trustee may have a duty to seek court intervention to modify such a trust when it is in the best interest of the trust to diversify. *See* Trent S. Kiziah, *The Trustee's Duty to Diversify: An Examination of The Developing Caselaw*, 36 ACTEC L. J. 357, 391 (2010) ("a trustee may have a duty to seek judicial relief from a mandatory clause if it is prudent to sell the concentration in order to prevent harm to the trust."). *See also Steiner v. Hawaiian Trust Company,* 393 P.2d 96 (Haw. 1964) (court held that the trustee had a duty to seek court relief if the grantor would not consent).

"Permissive" provisions typically broaden the normal investment authority of the trustee, either in general or specific terms. RESTATEMENT (THIRD) TRUSTS § 91, cmt. f. When a trust term "merely authorizes" a type or pattern of investment, the provision is considered to be permissive. *Id.* The distinction between mandatory and permissive provisions is significant because a trustee is under no duty to make or retain investments that are merely permissive by the terms of the trust. *Id*. "The fact that an investment is permitted does not relieve the trustee of the fundamental duty to act with prudence." *Id.* With respect to diversification, permissive provisions are strictly construed against dispensing with the diversification requirement altogether. *Id.* However, "a relaxation in the degree of diversification" typically required may be justified. *Id.*

Some jurisdictions may not be very receptive to a permissive clause limiting a trustee's liability. *See, e.g., Schartz v. Barker*, 291 P.3d 1073 (Kan. Ct. App. January 11, 2013) (court held that the following language did not eliminate the prudent investor rule in its entirety, the trust stated that the trustee had the power to invest and reinvest any and all funds coming into his possession "as he may in his absolute and uncontrolled discretion deem proper and suitable ... without limitation by any statute, custom, or rule or law, now or hereafter existing, relating to the investment of trust funds" and which further allowed the trustee to hold or retain as an investment any property or security delivered under the Trusts "without accountability for loss . . . [and] without any duty to convert or diversify, although they may not be the character generally regarded by law or custom as proper investments for trust funds"); *Fifth Third Bank v. Firstar Bank, N.A.*, 2006 Ohio 4506 (Ohio App. 2006) (stock retention language in trust did not limit trustee's liability); *Will of Dumont*, 791 N.Y.2d 868 (N.Y. Sur. 2004) (trust allowed a trustee to dispose of stock if there is a "compelling reason" to do so meant that the trustee may have abused discretion in not finding a compelling reason, though the court did not find that the trustee breached a duty to diversify). For example, in the *Dumont* case, the trial court scolded the trustee for not finding a reason to diversify:

> [T]he bank never attempted to prospectively define any triggering criteria which would raise a red flag for the trust officer in charge to raise a necessity of an immediate and more in-depth review. Good practice would dictate that upon the occurrence of a pre-determined significant event (such as a precipitous decline in stock value) the trust would undergo some form of intensive review to make sure that fiduciary duty is being properly upheld. Good practice would dictate a before-fall type of analysis to attempt to identify proper triggers which would call for such a review. Good practice would dictate complete documentation of all of these processes.

2004 N.Y. Slip Op. 50647U (June 25, 2004), *rev'd on other grounds*, 809 N.Y.S.2d 360 (N.Y. App. Div. 2006). *Wood*, 828 N.E.2d at 1078; *see also* Restatement (3d) of Trusts, 229 (A general authorization in an applicable statute or in the terms of the trust to retain

investments received as a part of a trust estate does not ordinarily abrogate the trustee's duty with respect to diversification or the trustee's general duty to act with prudence in investment matters.").

In *Hasty v. Castleberry*, the Georgia Supreme Court held that there was a fact question on whether the trustee breached its duty by not diversifying a concentration of stock. 749 S.E.2d 676 (Ga. 2013). The trust language specified that "any investment made or retained by [the Trustee] in good faith and with reasonable prudence shall be proper." *Id*. at 736-37. The plaintiff had expert testimony that "high concentrations of one stock investment such as the Wachovia stock held by the Marital Trust (i.e., where nearly 90% of one's assets are devoted to one stock) may present an unreasonable risk when the investment is supposed to be prudently managed for the benefit of others. As such, there is a genuine dispute as to whether William acted prudently as Trustee of the Marital Trust in retaining the Wachovia stock." *Id*.

In *Durden v. Citicorp Trust Bank*, the court determined that the trustee failed to carry its burden to show that the following clause exonerated it for any failure to diversify not grounded in bad faith: "trustees shall have the following powers: (b) To acquire, by purchase or otherwise, any property, real or personal, without being limited by any provision of law which restricts investments by fiduciaries and without regard to any principles of diversification, including but not limited to common and preferred stocks, bonds, mutual funds, common trust funds, secured and unsecured obligations and mortgages, or to sell, exchange or otherwise dispose of any such property, at public or private sale, without application to court, on any terms, including the extension of credit, which they deem advisable." No. 3:07-cv-974-J-34JRK, 2009 U.S. Dist. LEXIS 127347 (D.C. Fla. 2009).

The general concept with this line of precedent is that a trustee still has an overarching duty of prudence, and the trustee can be held liable for not being prudent in failing to decide to overrule the trust's nonspecific retention clause and sell the asset.

The majority of other jurisdictions have held that if a trust allows a trustee to exercise his discretion in a manner that might otherwise be inconsistent with the prudent investor rule, then the trustee's performance under that power does not give rise to a claim for breach of fiduciary duty. *See First Alabama Bank of Huntsville, N.A. v. Spragins,* 515 So. 2d 962 (Ala. 1987) (trust clause waived the duty to diversify); *Van Gundy v. Van Gundy, 292 P.3d 1201 (Co. Ct. App. 2012*) (trustee did not breach fiduciary duty where trust document allowed him "[t]o invest and reinvest in common stocks, preferred stocks, investment trusts, bonds, securities and other property, real or personal, foreign or domestic, including any undivided interest in any one or more common trust funds maintained by any corporate trustee, whether or not such investments be of the character permissible for investments by fiduciaries under any applicable law, and without regard to the effect any such investment or reinvestment may have upon the diversity of the investments."); *Perling v. Citizens & Southern National Bank*, 300 S.E.2d 649, 674 (Ga.

1983) (beneficiaries alleged that the trustees breached their fiduciary duty by not divesting stocks that fell in value, but the court granted judgment for the trustees because the trust had a clause that dictated that "any investment retained by the Trustee in good faith shall be proper, although of a kind or in an amount or proportion not authorized by law as suitable for the Trustee"); *Carter v. Carter*, 965 N.E.2d 1146 (Ill Ct. App. 2012) (court found for trustee where the settlor expressly gave trustee "the authority to invest in any property without regard to diversification and, as such, altered the requirements of the prudent investor rule"); *Americans for the Arts v. Ruth Lilly Charitable Remainder Annuity Trust #1*, 855 N.E.2d 592, 603 (Ind. Ct. App. 2006); *In re Wege Trust*, 2008 Mich. App. LEXIS 1259 (Mich. Ct. App. June 17, 2008) (trust document created a "safe harbor" protecting the bank "from the diversification requirement that ordinarily would be deemed prudent"); *Evans v. Bank One Trust Co.*, 2008 WL 540332 (Mich. Ct. App. February 28, 2008); *Warmack v. Crawford*, 239 Mo. App. 709, 195 S.W.2d 919, 925 (Mo. App. 1946) ("By the terms of the trust the requirement of diversification may be dispensed with."); *Bracket v. Tremaine*, 693 N.W.2d 514 (Neb. 2005) (retention clause relieved of duty to diversify farmland); *Puhl v. U.S. Bank, N.A.*, 34 N.E.3d 530 (Ohio Ct. App. 2015) (court held that where the trustee had "the full power and authority … [t]o retain any property or undivided interests in property received from any source regardless of lack of diversification, risk or nonproductivity…," this provision allowed the trustee to retain stocks regardless of the consequent lack of diversity in the trust's investment portfolio); *Nat'l City Bank v. Noble*, 2005 WL 3315034 (Ohio App 2005); *Atwood v. Atwood*, 25 P.3d 936, 942-43 (Okla. Civ. App. 2001) (where trust agreement gave the trustee broad discretion to invest "without being limited in the selection of investments by any statutes [or] rules of law," the trustee was not required to diversify trust holdings); *Donato v. BankBoston, N.A.*, 110 F.Supp.2d 42 (D.R.I. 2000) (trustee was relieved of the duty to diversify a concentration in stocks); *Holder v. First Tennessee Bank N.A. Memphis*, 2000 WL 349727 (Tenn. Ct. App. March 31, 2000) (retention clause allowed a trustee to retain concentration of stock); *W.A.K. II v. Wachovia Bank, N.A.*, 712 F. Supp. 2d 476, 481-82 (E.D. Va. 2010) (applying Virginia law) (language granting the trustee power to invest trust property "without being confined to investments lawful through statute or otherwise for fiduciaries in the State of Virginia" eliminated the prudent investor rule as to trust investments); *Hoffman v First Virginia Bank of Tidewater*, 263 S.W.2d 402 (Va. 1980) (trust clause allowing trustee to retain assets regardless of the duty to diversify waived such a duty); *Nelson v. First Nat'l Bank & Trust Co.*, 543 F.3d 432 (8th Cir. 2008) (court found for defendant trustee in suit for fiduciary breach based on a failure to diversify where the trust language was: "any investment made or retained by the trustee in good faith shall be proper despite any resulting risk or lack of diversification or marketability and although not of a kind considered by law suitable for trust investments"); *Robertson v. Central Jersey Bank & Trust Co.*, 47 F.3d 1268 (3rd Cir. 1995) (trust clause allowing the trustee to retain original assets waived duty to diversify). These cases relieved a trustee of the duty to diversify a concentration of an asset held in a trust where the trust document expressly stated that the trustee had the right to retain assets and did not have a duty to diversify.

For example, in *Puhl v. U.S. Bank, N.A.*, the court held that where the trustee had "the full power and authority … [t]o retain any property or undivided interests in property received from any source regardless of lack of diversification, risk or nonproductivity…," this provision allowed the trustee to retain stocks regardless of the consequent lack of diversity in the trust's investment portfolio. 34 N.E.3d 530 (Ohio Ct. App. 2015). The court distinguished the previous *Wood* case thusly:

> We find the present case to be clearly distinguishable. First, there is no indication in the record that the Trust at any time held stock in the Trustee's corporation. Hence, there is no reason to believe the above-quoted provision was aimed exclusively at the rule of undivided loyalty. Additionally, the "retention language" in the Trust specifically authorizes the Trustee to retain assets "regardless of lack of diversification." That is, whereas the *Wood* trust failed to mention diversification at all, the Trust presently at issue expressly relieves the Trustee of that duty.

Id.

Jurisdictions have also held that a more specific clause that expressly names the concentrated asset also waived a duty to diversify. *See National City Bank v. Noble,* 2005 WL 3315034 (Ohio App. 2005); *Baldus v. Bank of California*, 530 P.2d 1350 (Wash. Ct. App. 1975). For example, a more recent case under Mississippi law holds that a trustee can rely on a trust instrument's directions on diversification. In *Adams v. Regions Bank*, beneficiaries sued a trustee for multiple claims, including breach of fiduciary duty, arising from the trustee's failure to invest trust assets (stock in the trustee/bank). 2016 U.S. Dist. LEXIS 1027 (S.D. Miss. January 6, 2016). Adams, the primary beneficiary, and her children sued the bank for breaching its fiduciary duty in failing to diversify the trust's assets. The bank/trustee filed a motion for summary judgment, which the district court granted. Adams' diversification claim was that the trustee should have sold its own stock and invested in other, better assets. Adams' father's will stated that the trustee was "vested with the [] additional power[] . . . To retain, with no obligation to sell, any property coming into their hands as Trustees under the terms of this instrument, including stock in AmSouth Bancorp. [now the bank], whether or not the same would be treated as legal for the investment of trust funds and regardless of any lack of diversification or risk, without being liable to any person for such retention unless otherwise specifically provided herein . . . ." The court held that the will allowed the trustee to retain the stock and not diversify and held that the trustee did not breach its fiduciary duty in keeping the stock in the trust. *Id.*

The more specific a permissive clause is, the better chance there is for a court to find that it protects a trustee. For example, in the *Wood* case the court held that to end the duty to diversify, the trust should contain language authorizing or directing the trustee to retain in a specific investment a larger percentage of the trust assets than would normally be prudent." 828 N.E.2d at 1078. One commentator has stated: "Due to the fundamental

duty to diversify trust investments under the UPIA, if a settlor wants the trustee to hold corporate stock as the sole or primary assets of the trust the trust terms should expressly direct, or at least authorize, the trustee to retain the specific stock and explicitly relieve the trustee of the duty to diversify the trust's investments." *See* Mary C. Burdette, *Fiduciary Duties Within Fiduciary Duties, State Bar of Texas, Trust Owning Stock in a Closely–Held Corporation*, Advanced Estate Planning and Probate, pg. 4 (2012). A proposed permissive clause would be:

> The settlor and the beneficiaries have a special relationship to the [family farm, family business, stock, etc.], and one of the main purposes of the trust is to maintain that asset and the family's relationship to it. The trustee may indefinitely retain that asset in the trust and have no duty to sell or diversify that asset in any circumstance. Retaining this asset shall be proper despite any resulting risk or lack of diversification. With regard to this asset the trustee shall have no duty to invest with prudence, care, skill, and caution. The trustee shall not be liable to any party for any diminution in value of the trust that may result from retaining the asset. The trustee may sell the asset upon the following factors [].

Once again, there is not a particular form of a clause that will apply to all circumstances. The important aspects are to: 1) specifically mention the asset; 2) disclaim any duty to diversify or other trustee duties of prudence or care with regard to the asset; 3) acknowledge that there is a risk of a loss of value and still allow the trustee to retain the asset; and 4) provide a standard or factors that give the trustee guidance in making a decision to diversify.

C. Courts May Find An Implied Waiver Of The Duty To Diversify

There is also support for the argument that a silent trust document has an implied waiver of the duty to diversify for assets that were in the trust from inception. The Restatement provides:

> If the trust instrument is silent or the terms of the trust are otherwise unclear with respect to the retention of particular inception assets, it is a question of interpretation whether the terms of the trust include an implied authorization to the trustee to retain those investments. Specific mention of certain property in a will or other instrument by which the trust is established is ordinarily some indication of an intention of the settlor to authorize the trustee to retain that property.

RESTATEMENT (THIRD) TRUSTS § 92, cmt. c. For example, in the *Estate of Maxedon*, a settlor created a trust and placed a farm as its main asset. 946 P.2d 104 (Kan. App. 1997). After the trustee filed an accounting, a beneficiary objected to the trustee's failure to diversify. The court of appeals held:

> While the trust document did not expressly prohibit the trustee from selling the land, the trustee could properly have considered the fact that the subject land was placed into the trust by the settlor and comprised a majority of the corpus of the trust, thus indicating the settlor's intent that land remain the primary asset of the trust.

Id. at 109. Of course, this implied-waiver argument alone may be a dangerous approach for a trustee: "Notwithstanding the position of the Restatement and *Maxedon*, it is difficult to draw inferences from the manner in which a decedent invested." Trent S. Kiziah, *The Trustee's Duty to Diversify: An Examination of The Developing Caselaw*, 36 ACTEC L. J. 357, 380 (2010). "The better approach is for the grantor clearly to waive the duty to diversify if that is desired. Trustees should be reluctant to retain concentration based on inferences drawn from the grantor's actions, which are subject to numerous interpretations, when the grantor failed to express direction in the trust." *Id*.

D. Courts May Give Less Deference To Retention Clauses When Trustee Has Self-Dealing Investments

Courts around the country seem to give less deference to a trust's provision allowing for the retention of assets where the trustee relies on that provision to protect it from self-dealing situations. "Cases imposing liability on a trustee for the failure to diversify trust assets regardless of a general authorization to retain the investment usually involve factors demonstrating that the stock was directly related to the trustee or that the trustee acted with some element of bad faith." Elliot & Bennett, *Closely Held Business Interests and the Trustee's Duty To Diversify*, TRUSTS & ESTATES, trustsandestates.com (April 2009).

For example, in *Wood v. U.S. Bank, N.A.*, the trust agreement authorized the trustee to "[r]etain any securities in the same form as when received, including shares of a corporate Trustee," but it did not say anything about diversification. 160 Ohio App.3d 831, 2005-Ohio-2341, 828 N.E.2d 1072 (1st Dist.). The beneficiaries claimed a breach of the duty to diversify where stock in the trustee's corporation constituted nearly eighty percent of the trust's portfolio, and where, in the two years following the death of the settlor, the trust suffered a significant loss of value due to the trustee's liquidation of other assets of the trust prior to the liquidation of its own stock. The court agreed, finding that the retention language "merely served to circumvent the rule of undivided loyalty," and did not modify or eliminate the trustee's duty to diversify. *Id*. The court held that to end the duty to diversify, the trust should contain language authorizing or directing the trustee to retain in a specific investment a larger percentage of the trust assets than would normally be prudent." *Id*. at 1078.

In *Robertson v. Central Jersey Bank & Trust Co.*, a trust beneficiary brought suit against a trustee for breach of fiduciary duty in failing to diversify when the trustee kept 95% of trust assets invested in its own stock. 47 F.3d 1268 (3rd Cir. 1995). The trustee argued

that the testator intended to abrogate the duty to diversify by including a provision in the trust that gave the trustee broad discretionary power to retain assets in the trust without diversification. *Id*. The court of appeals rejected the trustee's argument and held that the trust clause does not "completely absolve [the trustee] from any duty to diversify" or "abrogate [the trustee's] general obligation to [act] with prudence." *Id*. at 1275. The court then reversed the trial court's grant of summary judgment in favor of the trustee, finding that the issue of whether the trustee breached its fiduciary duty by retaining its own corporate stock as 95% of the trust corpus was a fact question. *Id*. at 1279.

Similarly, in *First Alabama Bank of Huntsville, N.A. v. Spragins*, the Alabama Supreme Court held that the terms of a trust instrument directing the trustee to make new investments "as it may seem necessary or desirable, regardless of any lack of diversification, risk, or nonproductivity" did not lessen the duty imposed by the "prudent person" standard or prevent the fact finder from considering whether the trustee had breached his fiduciary duty in maintaining large proportion of trust's portfolio in the form of stock of the trustee bank's holding company. 475 So. 2d 512, 515-16 (Ala. 1985).

In *Schartz v. Barker*, the court held that the following language did not eliminate the prudent investor rule in its entirety, the trust stated that the trustee had the power to invest and reinvest any and all funds coming into his possession "as he may in his absolute and uncontrolled discretion deem proper and suitable ... without limitation by any statute, custom, or rule or law, now or hereafter existing, relating to the investment of trust funds" and which further allowed the trustee to hold or retain as an investment any property or security delivered under the Trusts "without accountability for loss . . . [and] without any duty to convert or diversify, although they may not be the character generally regarded by law or custom as proper investments for trust funds." 291 P.3d 1073 (Kan. Ct. App. January 11, 2013). The beneficiary complained about the trustee hiring his son as the investment manager and in investing in speculative investments in which the trustee and his son had also personally invested their money. *Id*.

Courts have been more critical of a trustee's using a retention clause or other similar clause to defeat a breach of fiduciary duty claim based on the failure to diversify investments when the trustee's alleged misfeasance revolved around an investment in the trustee's own business. This fact scenario certainly implicates other duties that a trustee owes, such as a duty of loyalty.

E. Trust Language That Generally Limits Liability: The Exculpatory Clause

It is common for settlors to execute trust documents that contain exculpatory clauses. An exculpatory clause is one that forgives the trustee for some action or inaction. For example, a common exculpatory clause may state "The trustee may rely upon the written opinion of any attorney" or "The trustee shall be saved harmless from any liability for any action he or she may take, or for the failure of such trustee to take any action, if done

in good faith and without gross negligence." Generally, these types of clauses can be enforceable in Texas and can limit a trustee's duty. *See Dolan v. Dolan*, No. 01-07-00694-CV, 2009 Tex. App. LEXIS 4487 (Tex. App.—Houston [1st Dist.] June 18, 2009, pet. denied). In Texas, exculpatory clauses are strictly construed, and a person is relieved of liability only to the extent to which it is clearly provided that he shall be excused. *See Jewett v. Capital Nat. Bank of Austin*, 618 S.W.2d 109, 112 (Tex. App.—Waco 1981, writ ref'd n.r.e.); *Martin v. Martin*, 363 S.W.3d 221, 230 (Tex. App.—Texarkana 2012, pet. dism'd by agr.).

In *Texas Commerce Bank v. Grizzle*, the Texas Supreme Court held that public policy as expressed by the legislature in the Trust Code allowed relieving a corporate trustee from liability for self-dealing except for what was specified in sections 113.052 and 113.053. 96 S.W.3d 240, 249 (Tex. 2002). The Court stated that "[w]hile the Trust Code imposes certain obligations on a trustee—including all duties imposed by the common law—the Trust Code also permits the settlor to modify those obligations in the trust instrument." *Id*. at 249. Specifically, the Court held that "the trust Code authorizes a settlor to exonerate a corporate trustee from almost all liability for self-dealing," such as misapplying or mishandling trust funds, including failing to promptly reinvest trust monies. *Id*. at 250 The Court also held that public policy did not bar such exculpatory clauses: "We disagree with the court of appeals' conclusion that public policy precludes such a limitation on liability." *Id*. "The Legislature has expressly authorized the use of exculpatory clauses, stating that they can relieve a corporate trustee from liability except for certain narrow types of self-dealing not at issue here. We therefore decline to hold that a trust instrument cannot exonerate a trustee from liability for failing to promptly reinvest trust monies based on public policy." *Id*. Accordingly, Texas courts seem willing to follow the settlor's intent despite other public policy considerations. *Id.; see also Clifton v. Hopkins*, 107 S.W.3d 755 (Tex. App.—Waco 2003, no pet.).

In response to *Grizzle*, the Texas Legislature amended the Texas Property Code, and it now limits a settlor's ability to exculpate a trustee. Section 111.0035 provides that the terms of a trust may not limit a trustee's duty to respond to a demand for an accounting or to act in good faith. Tex. Prop. Code Ann. §111.035(b)(4). Additionally, Texas Property Code section 114.007 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 of liability for: (1) a breach of trust committed: (A) in bad faith; (B) intentionally; or (C) with reckless indifference to the interest of a beneficiary; or (2) any profit derived by the trustee from a breach of trust." Tex. Prop. Code Ann. §114.007.

In *Martin v. Martin*, the court of appeals discussed the new statutory provisions and their impact on *Grizzle* and found that an exculpatory clause in the trust document at issue was not enforceable to protect the trustee from actions where he had a conflict of interest. 363 S.W.3d 221 (Tex. App.—Texarkana 2012, pet. denied). In *Martin*, a company was jointly managed for over twenty years by Ruben Martin and Scott Martin. They each created an

irrevocable trust for the health, education, and welfare of their children and grandchildren. The brothers were the trustees of each other's trust. Thereafter, a power struggle over the control of the company arose between Ruben and Scott.

Ruben's children filed a lawsuit to remove Scott as the trustee of their trust and alleged breaches of fiduciary duty. Ultimately, the jury found for Ruben's children and ordered over a million dollars in damages to each of them as against Scott. Scott appealed and argued that he had no fiduciary duty of loyalty based on a provision of the trust releasing Scott of fiduciary duties except those imposed by a statute.

The court of appeals held that under the common law, a trustee has the fiduciary duties to hold and manage the property for the benefit of the beneficiaries and owes a trust beneficiary an unwavering duty of good faith, fair dealing, loyalty, and fidelity over the trust affairs and its corpus. Scott argued that the trust document excused him from the obligation to perform such duties.

The court of appeals held that the general rule from the Texas Trust Code is that the terms of the trust prevail over any provision of the code subject to a few statutory exceptions not applicable to the case. The trust document granted the trustee the right to operate to the same extent and manner as if he were a disinterested person. Further, it recognized that no principle or rule relating to "self-dealing or divided loyalty shall be applied to any act of the trustee but that the trustee shall be held to the same standard of liability" as in transactions with disinterested persons.

The court held that Scott would be accountable for fiduciary responsibility only if the Texas Trust Code expressly prohibited the exculpation clause contained in the trust. Scott argued that pursuant to the Texas Supreme Court's *Grizzle* opinion, that the trust agreement waived all fiduciary duties. The court of appeals disagreed and found Scott's argument ignored the statutory changes that had occurred after *Grizzle* was decided.

The court noted that in response to *Grizzle* the Texas Legislature repealed section 113.059, added section 111.0035, and added section 114.007. Section 111.0035(b) provides as follows:

> The terms of a trust prevail over any provision of this subtitle, except that the terms of a trust may not limit:
>
> (1) the requirements imposed under § 112.031;
>
> (2) the applicability of § 114.007 to an exculpation term of a trust;
>
> (3) the periods of limitation for commencing a judicial proceeding regarding a trust;

(4) a trustee's duty:

(A) with regard to an irrevocable trust, to respond to a demand for accounting made under § 113.151 if the demand is from a beneficiary who, at the time of the demand:

(i) is entitled or permitted to received distributions from the trust; or

(ii) would receive a distribution from the trust if the trust terminated at the time of the demand; and

(B) to act in good faith and in accordance with the purposes of the trust.

Tex. Prop. Code Ann. § 111.0035.

Section 114.007 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.

Id. at § 114.007.

The court of appeals held that Scott owed Ruben's children the fiduciary duties which, pursuant to section 111.0035 and section 114.007, cannot be waived. The statutory changes modified the holding of *Grizzle*.

Scott also argued that another provision of the trust document required reversal: "no individual trustee shall be liable for negligence or error of judgment, but shall be liable only for such trustee's willful misconduct or personal dishonesty." The court held that section 114.007 prohibits liability from being waived if the breach was committed in bad faith, intentionally, or with reckless indifference to the interest of the beneficiaries. The court noted that the jury found that the breach was committed in "an absence of good faith, intentionally or with reckless indifference to the interest of the beneficiaries." The court found that section 114.007 would prohibit any waiver of liability and held that the exculpatory clauses at issue did not excuse Scott from his actions. There was sufficient

evidence to support the jury's liability finding that Scott had breached his fiduciary duties.

There is a theoretical difference between a retention clause and an exculpation clause. A retention clause may set the standard for a trustee's duty. A trustee may have an affirmative duty to retain an asset or may have the ability to retain an asset. That means that a trustee does not breach a duty by retaining an asset. An exculpation clause, however, forgives a trustee for a breach of trust. Accordingly, there is an argument that the statutory limitations on exculpation clauses may not apply to a retention clause.

In *Neuhaus v. Richards*, beneficiaries sued the trustee for failing to diversify trust assets by retaining stock in the trust and the court of appeals equated a retention clause with an exculpation clause. 846 S.W.2d 70, 74 (Tex. App.—Corpus Christi 1992), *judgment set aside without reference to merits to effect settlement agreement*, 871 S.W.2d 182 (Tex. 1994). The court held that "an exculpatory provision in the trust instrument is not effective to relieve the trustee of liability for action taken in bad faith or for acting intentionally adverse or with reckless indifference to the interests of the beneficiary." *Id*. Accordingly, the court held that even if the trust agreement exculpated the trustees from all liability, it could not have done so for willful misconduct or personal dishonesty. Because one of the alleged breaches of fiduciary duty was willful misconduct, the court held that summary judgment was improper because the trustees made no attempt to negate allegations of willful misconduct.

In *Shands v. Texas State Bank*, beneficiaries sued an agent of the executor for not funding a trust and then not investing or diversifying the assets appropriately. No. 04-00-00133-CV, 2001 Tex. App. LEXIS 109 (Tex. App.—San Antonio January 10, 2001, no pet.). The trial court granted summary judgment for the bank, and the beneficiary appealed that decision. The court of appeals affirmed the summary judgment. The court stated that an exculpatory clause ("no Trustee shall be liable for any act or omission except in the case of gross negligence, bad faith or fraud…") in the will protected the bank from liability. The bank produced expert testimony explaining that it did not invest the funds because it was not directed to do so by the executor. The court of appeals held that the beneficiary did not controvert this evidence and affirmed the summary judgment. *Id*. at *26-27.

An exculpatory clause is effective in Texas up to a point. It can protect a trustee from negligent actions or mistakes that fall short of being bad faith or grossly negligent.

VII. Methods To Limit Trustee Liability For Not Diversifying

If a trustee and/or beneficiaries do not want to diversify assets or want under diversification, there are methods in Texas to protect a trustee from liability for doing so.

A. Non-Judicial Methods

1. Retention/Waiver Clause

A settlor can add a clause to a trust that limits a trustee's duty to diversify a trust. This can be a mandatory clause that requires a trustee to not diversify an asset and requires that the trustee retain the asset. It can also be a permissive clause that attempts to limit the liability for a trustee retaining an asset, but also allows a trustee to sell the asset based on certain factors and considerations. Depending on the wording of the clause, this can be an effective method to limit a trustee's liability.

2. Exculpatory Clause

A settlor can add a clause to a trust that limits a trustee's liability for negligent activities or mistakes. This type of clause would not be limited to just a duty to diversify, but would likely cover all duties and activities. As stated above, there are certain statutory limits on exculpatory clauses. But they are enforceable in Texas up to a point and can assist in limiting risk and liability.

3. Statement on Special Circumstances

A settlor can add a statement to a trust that impacts a trustee's duty to diversify a trust. A settlor can add statements to a trust that describe its purposes and special relationships to particular assets. Settlors can even describe investment plans and suggestions. For example, a settlor can describe the purpose of a trust as retaining control of a family business for the family and ensuring that family members will have an opportunity to work in the business. "Indeed, if the trust is new and in the process of being drafted, counsel can greatly help the settlor and trustee minimize the diversification problem by being as specific as possible about the settlor's purposes of the trust, desires regarding negation of the duty to diversify, acknowledgment of the lack of marketability of the family company stock, and overall vision for the company." Elliott and Bennett, *Closely Held Business Interests And A Trustee's Duty to Diversify*, Trusts & Estates, trustsandestates.com (April 2009).

4. Other Related Documents

A family can create other related documents that may impact a trustee's ability to sell assets. For example, assets can be placed in closely held entities that contain buy-sell provisions that limit a party's ability to dispose of the asset. That way, if a trustee wants to sell the asset, it will have to have the consent of other parties. Further, the entity can

have voting and nonvoting shares, and the settlor can fund the trust solely with nonvoting shares. That way, the trustee has no authority to dispose of assets.

5. Directed Trust Provisions

Texas has new statutory provisions that allow a trust document to permit a trustee to delegate certain duties. Tex. Prop. Code Ann. § 114.0031. A trustee can delegate the investment decisions concerning a certain asset to a third party (maybe a family member) to determine whether to retain the asset or not retain the asset. "Depending on the trust's terms, the independent trustee may find relief from its duty to diversify by refraining from taking part in the family trustee's unilateral decision to continue the trust's concentrated holdings in the family company ownership." Elliott and Bennett, *Closely Held Business Interests And A Trustee's Duty to Diversify*, Trusts & Estates, trustsandestates.com (April 2009). "For example, if the terms of the trust provide that the family trustee's decision controls in the case of disagreements concerning investments, the independent trustee could document (by trustee resolution or otherwise) its opposition to the non-diversification of family business assets and trigger relief from liability pursuant to the trust instrument." *Id*.

6. Decanting Trust

Texas has new statutory provisions that allow a trust to be decanted, i.e., the assets be transferred into a new trust. Tex. Prop. Code Ann. § 112.071-87. If a trust document does not contain any statements limiting the trustee's duty to diversify, perhaps the assets should be transferred into a new trust that has different administrative terms that allow a trustee to avoid diversification. The statute does state that a trustee may not use the decanting statute to "materially limit a trustee's fiduciary duty under the trust or as described by Section 111.0035" or "decrease or indemnify against a trustee's liability or exonerate a trustee from liability for failure to exercise reasonable care, diligence, and prudence." *Id*. at § 112.085. This is a very new statute in Texas and its limitations have not been fully developed.

7. Settlor Consent And Release

For a revocable trust, a settlor may revoke, modify or amend the trust at any time before the settlors' death or incapacity. Tex. Prop. Code Ann. § 112.051. Accordingly, in a revocable trust situation, a settlor may modify or amend a trust to specifically relieve a trustee from a duty to diversify. *See Puhl v. U.S. Bank, N.A.*, 34 N.E.3d 530 (Ohio Ct. App. 2015) (court held that in a revocable trust, during her lifetime, the settlor had the authority to instruct the trustee to retain stocks, and the trustee had the duty to follow those instructions regardless of the risk presented by the nondiversification). However, if the settlor becomes incapacitated, then a guardian must seek approval from a court to modify a revocable trust. *Weatherly v. Byrd*, 566 S.W.2d 292, 293 (Tex.1978).

Additionally, the trustee should seek a written consent, release, and indemnity agreement from the settlor in a revocable trust situation and may also want to seek court approval.

8. Beneficiary Consent And Release

A beneficiary who has full capacity and acting on full information may relieve a trustee from any duty, responsibility, restriction, or liability that would otherwise be imposed by the Texas Trust Code, and this release must be in writing and delivered to the trustee. Tex. Prop. Code Ann. § 114.005. The trustee should be careful to properly word the release or else certain conduct may be outside of the scope of the release. *See, e.g., Estate of Wolf*, 2016 NYLJ LEXIS 2965 (July 19, 2016) (release did not protect trustee from diversification claim that arose after the effective dates for the release).

Further, writings between the trustee and beneficiary, including releases, consents, or other agreements relating to the trustee's duties, powers, responsibilities, restrictions, or liabilities, can be final and binding on the beneficiary if it is in writing, signed by the beneficiary, and the beneficiary has legal capacity and full knowledge of the relevant facts. Tex. Prop. Code Ann. § 114.032. Minors are bound if a parent signs, there are no conflicts between the minor and the parent, and there is no guardian for the minor. *Id*. A court may not enforce a release if disclosure was not adequate. *See, e.g., Hale v. Moore*, 2008 WL 53871 (Ky. Ct. App. January 4, 2008). Release agreements should have detailed disclosures in the recitals and there should be written disclosures explaining release language.

9. Beneficiary Retention Agreement

Potentially, a trustee and the beneficiaries can enter into an agreement that allows the trustee to retain certain assets without any liability for doing so until some point in the future when the beneficiaries provide written notice that they want the trustee to diversify the assets. For example, in *Adams v. Regions Bank*, beneficiaries sued a trustee for multiple claims, including breach of fiduciary duty, arising from the trustee's failure to diversify trust assets (stock in the trustee/bank). 2016 U.S. Dist. LEXIS 1027 (S.D. Miss. January 6, 2016). The beneficiary signed a retention agreement with the trustee that provided that the trustee could keep the stock in the trust until she provided written notice that it should be sold. Even though the beneficiary stated that she told the trustee to sell the stock, she had no evidence that such a directive was done in writing. The court held that retention agreement allowed the trustee to retain the stock and not diversify and held that the trustee did not breach its fiduciary duty in keeping the stock in the trust. *Id.*

10. Beneficiary Written Directives

Many courts have held that it is appropriate for a trustee to consider an express direction from a beneficiary when deciding whether to sell and diversify the trust's assets. Once again, the Prudent Investor Act lists certain circumstances that a trustee may consider in managing and investing trust assets, and one of those circumstances is "[a]n asset's

special relationship or special value, if any, to the purposes of the trust or to one (1) or more of the beneficiaries." Tex. Prop. Code Ann. § 117.004(c)(8). The official comment to this statute explains that this subsection would allow the trustee "to take into account any preferences of the beneficiaries respecting heirlooms or other prized assets." *Id*. at cmt. Therefore, it was not improper for a trustee to consider a beneficiary's directions when considering whether to sell and diversify the assets in a trust. *See, e.g., Glass v. SunTrust Bank*, No. W2015-01603-COA-R3-CV, 2016 Tenn. App. LEXIS 305 (Tenn. Ct. App. May 4, 2016) (trustee did not breach duty by retaining stock where beneficiary sent letter requesting same); *Adams v. Regions Bank*, No. 3:14CV615-DPJ-FKB, 2016 U.S. Dist. LEXIS 1027, 2016 WL 71429, at *10 (S.D. Miss. Jan. 6, 2016) (concluding that "special circumstances" existed within the meaning of Mississippi's version of the Uniform Prudent Investor Act where the beneficiary approved of the retention of stock by signing a retention agreement; the trustee did not breach its duties by failing to diversify); *In re Trust Created By Inman*, 269 Neb. 376, 693 N.W.2d 514, 521 (Neb. 2005) (noting that a beneficiary's professed sentimental attachment to farmland could be a special circumstance justifying non-diversification); *Wood v. U.S. Bank, N.A.*, 160 Ohio App. 3d 831, 2005 Ohio 2341, 828 N.E.2d 1072, 1079 (Ohio Ct. App. 2005) (stating that the "special circumstances" language in the UPIA includes situations involving "holdings that are important to a family or a trust"). As the Glass court stated:

> Having carefully reviewed the record, we agree with the trial court's conclusion that SunTrust did not breach a duty to Plaintiff by failing to liquidate the bank stock and diversify the portfolio. Plaintiff had executed written documentation electing an in-kind distribution of the stocks in the estate, acknowledging that SunTrust would continue to hold "these securities" for his benefit. Plaintiff's actions over the course of the next year were consistent with SunTrust's understanding of the in-kind election letter. The Glass family had owned these stocks for years, and they continued to pay large dividends to the trust during the administration period. SunTrust did not have a mandatory duty to diversify because it "reasonably determine[d] that, because of special circumstances, the purposes of the trust [were] better served without diversifying." Tenn. Code Ann. § 35-14-105(a)(1). Given the circumstances existing at the time, and the limited duration of the trust, SunTrust acted as a reasonably prudent person and was not negligent in its decision regarding diversification.

Glass v. SunTrust Bank, 2016 Tenn. App. LEXIS 305, *35.

11. Trustee Resolution

Another potential method to limit liability and risk is for the trustees to adopt a resolution containing a comprehensive investment plan that will apply from that time forward discussing the concentration of the investment and what factors the trustees will consider in the future to reevaluate the retention of the asset. "For example, the trustees could cite

the settlor's desire that the family business stay closely held, intact and owned by family members or trusts for their benefits without regard to diversification." Elliott and Bennett, *Closely Held Business Interests And A Trustee's Duty to Diversify*, Trusts & Estates, trustsandestates.com (April 2009). The trustees could have the settlors and the beneficiaries sign off on this plan to show their consent and the settlor's intentions for the trust.

Practice Tip: If a trustee determines to retain an asset and not diversify, it should memorialize that decision in writing and give all of the reasoning involved in making the decision. A trustee should maintain a file that demonstrates that it has acted prudently and in good faith as it exercises its discretion. Courts are more critical of the failure to exercise discretion than an honest mistake in exercising discretion.

12. Beneficiary Ratification

Consents, in a perfect world, exist before a trustee begins managing an asset. If the trustee wants protection after it has been managing an asset for a while, a trustee may want to seek a ratification in addition to a consent and release. A beneficiary's knowledge and acquiescence in a trustee's failure to diversify may not be any protection for the trustee nor does a beneficiary's knowledge of a trustee's failure to invest trust funds does not, by itself, relieve the trustee from liability. *Landford v. Shamburger*, 417 S.W.2d 438, 445 (Tex. App.—Fort Worth 1967, writ ref'd n.r.e.), *disapproved on other grounds, Texas Commerce Bank v. Grizzle*, 96 S.W.3d 240, 251 (Tex. 2002). However, beneficiaries may be able to ratify a trustee's actions. *See Burnett v First Nat'l Bank of Waco,* 536 S.W.2d 600 (Tex. Civ. App.—Eastland, writ ref'd n.r.e.) (a beneficiary also may, by his consent, acquiescence or ratification, be estopped to complain of a trustee's failure to diversify if the beneficiary had full knowledge of all material facts). Rather, the trustee should seek a written consent and release based on full information. If there are several beneficiaries, all of them must consent before the trustee is safe from liability. *See* RESTATEMENT (SECOND) OF TRUSTS § 216 cmt. g (1959). For the ratification to be valid, the ratifying beneficiaries should be aware of all material facts involved in the acts they ratify and of their rights in the matter, and must not be prevented from exercising those rights. *See e.g., Marcucci v. Hardy*, 65 F.3d 986 (1st Cir. 1995); *In re Estate of Lange*, 383 A.2d 1130, 1137-38 (N.J. 1978).

A. Judicial Methods

1. Judicial Modification Of Trust

If a trust document does not limit the duty of diversification, the parties may seek a modification of the trust to accomplish that goal. For example, "When the original mandate to hold family company stock in a concentrated fashion without regard to diversification is unclear, a large increase in value over time and an increased dominance

of family company equity ownership as a percentage of trust assets may be sufficient to persuade a court in a UTC state to specifically negate the duty to diversify." Elliott and Bennett, *Closely Held Business Interests And A Trustee's Duty to Diversify*, Trusts & Estates, trustsandestates.com (April 2009).

In Texas, on the petition of a trustee or a beneficiary, a court may modify an irrevocable trust and allow a trustee to do things that are not authorized or that are forbidden by the trust document 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 the administrative, nondispositive terms of the trust is necessary or appropriate to prevent waste or avoid impairment of the trust's administration; or (4) the order is necessary or appropriate to achieve the settlor's tax objectives and is not contrary to the settlor's intentions. Tex. Prop. Code Ann. § 112.054. The first three grounds do not require the agreement of all interested parties; whereas, the fourth ground does require that all beneficiaries agree. Additionally, if all beneficiaries consent, a court may enter an order that is not inconsistent with a material purpose of the trust. *Id*. So, if all beneficiaries agree, it should be relatively easy to modify a trust document to insert appropriate language abrogating a duty to diversify or directing the trustee to retain and maintain certain trust assets. The settlor and all beneficiaries may consent to modify a trust. *Musick v. Reynolds*, 798 S.W.2d 626, 629 (Tex. App.—Eastland 1990, writ denied). This requires that all parties have capacity to consent. *Id*. Even if all beneficiaries do not agree, it is still possible to do so, though it may be more difficult.

2. Judicial Approval Of Investment Plan

In addition to, or instead of, consents/releases/indemnities, a trustee or a beneficiary may seek court approval of the waiver of the duty to diversify. The Texas Trust Code allows for advance judicial approval. Tex. Prop. Code Ann. §115.001. The Texas Civil Practice and Remedies Code also allows a court to declare the rights or legal relations regarding a trust and to direct a trustee to do or abstain from doing particular acts or to determine any question arising from the administration of a trust. Tex. Civ. Prac. & Rem. Code Ann. § 37.005; *Cogdell v. Fort Worth Nat'l Bank*, 544 S.W.2d 825, 829 (Tex. Civ. App.—Eastland 1977, writ ref'd n.r.e.) (the trustee settled claims and sought judicial approval of the settlement agreement).

Even where all parties consent and may agree to release the trustee, a trustee may still want a court order allowing the trustee to not diversify or to underdiversify assets. That is certainly the safest, most conservative approach. *In re Estate of Boylan*, No. 02-14-00170-CV, 2015 Tex. App. LEXIS 1427 (Tex. App.—Fort Worth Feb. 12, 2015, no pet.) ("A breach of trust may be found even though the trustee acted reasonably and in good faith, perhaps even in reliance on advice of counsel.").

A trustee or a beneficiary may seek court intervention to modify a trust to relieve a trustee of the duty to diversify. For example, if a trustee states that it has to sell the family farm in order to meet its duty to diversify, a beneficiary may file suit to relieve the trustee from the duty and to seek an order from the court to stop the trustee from selling the farm. For further example, if the trustee and the beneficiaries agree that they do not want to sell the family farm, they may jointly seek an order from a court to relieve the trustee of the duty to diversify, which would give the trustee added protection for any future disputes about the decision to retain the farm.

3. Statute of Limitations/Disclosure of Investment Plan

In Texas courts of appeals have applied the four-year statute of limitations applicable to suits for breach of fiduciary duty. Tex. Civ. Prac. & Rem. Code § 16.004(a)(5). As a general rule, a cause of action accrues when a wrongful act causes some legal injury, even if the fact of injury is not discovered until later, and even if all resulting damages have not yet occurred. *See Murphy v. Campbell*, 964 S.W.2d 265, 270 (Tex. 1997). A "legal injury" is "an injury giving cause of action by reason of its being an invasion of a plaintiff's right . . . be the damage however slight.'" *Murphy*, 964 S.W.2d at 270 (quoting Kennedy). Though, generally, accrual of a cause of action is a matter of law, it can be a fact question under the appropriate circumstances. *See Ward v. Standford*, 443 S.W.3d 334 (Tex. App.—Dallas 2014, pet. denied) (accrual was a fact question on when trustees breached duties by not pursuing a claim against the settlor).

Disclosure of the trustee's investment decisions is very important to the application of the statute of limitations defense. The discovery rule is an exception to the legal injury rule. *Murphy*, 964 S.W.2d at 270. Under the discovery rule, an action does not accrue until the plaintiff knew or in the exercise of reasonable diligence should have known of the wrongful act and resulting injury. *Id*. The discovery rule applies in cases of fraud, fraudulent concealment, and in other cases in which the nature of the injury incurred is inherently undiscoverable and the evidence of injury is objectively verifiable. *Id*.

Fraudulent concealment is also an affirmative defense to the statute of limitations. *See KPMG Peat Marwick v. Harrison Cnty. Hous. Fin. Corp.*, 988 S.W.2d 746, 749 (Tex. 1999). The party asserting fraudulent concealment has the burden to come forward with evidence raising a fact issue on each element of that defense. *See id*. A party asserting fraudulent concealment must establish an underlying wrong, and that "the defendant actually knew the plaintiff was in fact wronged, and concealed that fact to deceive the plaintiff." *BP Am. Prod. Co. v. Marshall*, 342 S.W.3d 59, 67 (Tex. 2011) (quoting *Earle v. Ratliff*, 998 S.W.2d 882, 888 (Tex. 1999)). Fraudulent concealment only tolls the running of limitations until the fraud is discovered or could have been discovered with reasonable diligence. *Id*. Unlike the discovery rule, the doctrine of fraudulent concealment is fact-specific. *Id*.

Therefore, a beneficiary will not have a discovery rule or fraudulent concealment defense to the statute of limitations defense if the trustee properly and timely communicates to the beneficiary the investment decisions that have been made. For example, in *Thompson v. Butler*, beneficiaries sued a trustee for various allegations for breach of fiduciary duty. 2013 Ohio App. LEXIS 957 (Ohio Ct. App. March 22, 2013). One of the allegations was that the trustee breached his duties by not divesting of a concentration of stock. The court noted: "Ann Thompson testified that the discontinued divestment was an issue the Thompsons discussed in 2005, and Mark and Christie Thompson received quarterly account statements that would have shown the lack of sales. Therefore, if Key Bank stopped selling Key Corp. stock in 2005, the Thompsons knew or should have known about the discontinued divestment prior to July 2006." *Id*. *P21. The court affirmed the trial court's summary judgment on the basis of the statute of limitations: "Because the Thompsons filed their breach-of-trust claim more than four years after they knew or should have known the factual basis for each alleged breach, the trial court properly found the claim time barred. . . ." *Id*. at *P29.

It should be noted that although there is a four-year statute of limitations for damage claims in Texas, that there is no statute of limitations for suits to remove a trustee. *See Ditta v. Conte*, 298 S.W.3d 187 (Tex. 2009) ("[L]imitations periods continue to dictate when claims for fiduciary breaches must be brought. While the four-year limitations period proscribes whether an interested person can obtain monetary recovery from a trustee's fiduciary breach, it does not affect whether the interested person can seek that trustee's removal. To hold otherwise would allow trustees who previously harmed the trust relationship to remain in their fiduciary roles, regardless of their past transgressions.").

VIII. Ramifications For Failing To Limit Liability And For Not Diversifying

If a trustee fails to diversify assets and fails to meet its duty of care, then there may be drastic implications for the trustee. At the end of the day, administering a trust is a balance of risk and reward. Reward being the compensation that a trustee earns and the risk being the chance that a beneficiary may sue a trustee for its actions or inactions. In this context, unfortunately, most determinations of whether a trustee breached its duty to diversity will be made after an asset has not performed up to the level that a beneficiary (or trustee) may desire. As they say, hindsight is twenty/twenty. So, a judge or jury will be asked to determine whether a trustee breached its duty to diversify after everyone knows that retaining the asset may have harmed the trust. This is true even though the propriety of a trustee's investment strategy must be judged as it appeared at the time it was made and not when viewed in hindsight. *People's State Bank & Trust Co. v. Wade*, 269 Ky. 89, 106 S.W.2d 74, 76 (1937); *Estate of Pew*, 440 Pa. Super. 195, 655 A.2d 521, 523-24 (1994).

Further, a beneficiary may not solely allege a breach of the duty to diversify. A beneficiary may also allege the breach of other duties, such as the duty of loyalty

(maintaining an asset connected to the trustee), prudence (not selling an asset when it would be prudent to do so), and impartiality (maintaining a certain asset to benefit one beneficiary over another beneficiary's interests). *See*, *e.g.*, Tex Prop. Code Ann. §§ 177.007 (duty of loyalty), 117.008 (duty of impartiality). Some commentators do not feel that a retention clause is sufficient to waive other trustee duties: "a clause simply waiving the duty to diversify, without more, merely waives the duty to diversify, nothing more. A waiver of the duty to diversify does not waive the trustee's duty to invest prudently in light of the purposes, terms, distribution requirements and other circumstances of the trust. Nor does a waiver of the duty to diversify waive the trustee's duty to invest with care, skill, and caution." Trent S. Kiziah, *The Trustee's Duty to Diversify: An Examination of The Developing Caselaw*, 36 ACTEC L. J. 357, 394 (2010). However, as noted above, there are numerous cases absolving trustees from all liability for relying on retention provisions.

A. Statutory Remedies

The Texas Trust Code has express remedies available to a beneficiary for a trustee's breach of fiduciary duty. Texas Trust Code section 114.008 allows a court to compel a trustee to act, enjoin a trustee from breaching a duty, compel a trustee to redress a prior breach, order a trustee to account, appoint a receiver, suspend the trustee, remove the trustee, reduce or deny compensation, void an act of the trustee, impose a lien or a constructive trust, or order any other appropriate relief. Tex. Prop. Code Ann. §114.008. Trust Code Section 113.082 provides that a court may remove a trustee if: the trustee materially violated a term of the trust or attempted to do so and that resulted in a material financial loss to the trust; the trustee fails to make an accounting that is required by law or by the terms of the trust; or the court finds other cause for removal. *Id*. at §113.082. Court may reduce or deny a trustee compensation for breaches of duty. *Id*. at § 114.008, 114.061. A plaintiff only needs to prove a breach (and not causation or damages) when she seeks to forfeit some portion of trustee compensation. *Longaker v. Evans*, 32 S.W.3d 725, 733 n.2 (Tex. App.—San Antonio 2000, pet. withdrawn). Texas Trust Code section 114.064 provides: "In any proceeding under this code the court may make such award of costs and reasonable and necessary attorney's fees as may seem equitable and just." *Id*. at § 114.064. So, if a beneficiary sues for removal and/or breach of a duty, a court may order the trustee, individually, to pay the beneficiary's attorney's fees.

B. Common-Law Damages Suit

In addition to statutory remedies, a beneficiary may sue a trustee for breaching fiduciary duties for not diversifying an asset. Courts have held a trustee liable for breaching fiduciary duties for not diversifying assets where the trust document was silent on the duty to diversify. *See, e.g.*, *In re Janes,* 90 N.Y.2d 41 (1997); *In re Rowe*, 274 A.D.2d 87 (N.Y.App. Div. 2000). At the outset, a beneficiary is not entitled to an award of damages for a trustee's breach of duty. Rather, any award should go to the trust itself. *Fetter v. Brown*, No. 10-13-00392-CV, 2014 Tex. App. LEXIS 11209 (Tex. App.—Waco October

9, 2014, pet. denied) (beneficiary was not entitled to award of damages as they should have been awarded to trust). Further, the plaintiff will have the burden of prove the trust suffered damages from the investing decisions. *See Middleton v. PNC Bank, NA*, 2014 Ky. App. Unpub. LEXIS 846 (Ky. Ct. App. October 31, 2014) (affirmed summary judgment for trustee where plaintiff could not prove damages from investing plan).

Courts will review a trustee's investment decision based on a totality of different factors. Further, a trial court should not interfere with a trustee's discretion even if it disagrees with an investment plan. *See In re Mark Anthony Fowler Special Needs Trust*, 2011 Wash. App. LEXIS 358 (Wash. Ct. App. February 8, 2011). "The court should engage in a balanced and perceptive analysis of the trustee's consideration and action in the light of the history of each individual investment, viewed at the time of its action or its omission to act; and [] all the facts and circumstances of the case must be examined to determine whether a concentration of a particular stock in an estate's portfolio violates the prudent person standard." *In re Rowe*, 712 N.Y.S.2d 662, 665 (N.Y. 2001). Of course, the standard is now a prudent investor standard, so "a trustee shall exercise reasonable care, skill and caution to make and implement investment and management decisions as a prudent investor would for the entire portfolio, taking into account the purposes and terms and provisions of the governing instrument." *In re HSBC Bank USA, N.A.*, 947 N.Y.S.2d 292, 300 (App. Div. 2012). "[T]he prudent investor rule puts diversification at the forefront of the fiduciary's obligations, but allows leeway for the fiduciary to opt out if the beneficiaries require otherwise or if the testator/settlor directed a different course of action." *Id*.

For example, in *In Matter of Knox*, the court addressed a trust that was funded with shares of Woolworth, which the grantor had co-founded, and shares of Marine Trust Company of Western New York. 98 A.D.3d 300 (N.Y. 2012). The Trust Company was named as sole trustee and was given a power to invest trust funds "without regard to diversification or to limitations or restrictions of any kind." *Id*. at 305. The trust instrument further provided that the trustee was authorized to consult with counsel, and would be protected in connection with any action taken in good faith under advice of counsel. When the trustee filed an account, covering the years 1957 through 2005, the adult income beneficiaries and the guardian ad litem for the minor remainder beneficiaries filed objections to the trustee's retention of the Woolworth stock. The court noted that under the prudent investor rule and its predecessors, "it is not sufficient that hindsight might suggest that another course would have been more beneficial; nor does a mere error of investment judgment mandate a surcharge." *Id*. at 309. The court noted that "it is well established that retention of securities received from the creator of the trust may be found to be prudent even when purchase of the same securities might not." *Id*. Finally, the court noted that "[a]t times, holding an overweight concentration of a security may be in the best interests of the beneficiaries." *Id*.

In *Matter of Ely*, the court found that that although the trustee retained a concentration in four stocks, it satisfied the applicable prudent investor standards because: (1) the stocks were on the bank's approved list; (2) the investments complied with the beneficiary's direction that the investments focus on long-term growth; (3) the bank was in compliance with its own internal policies; and (4) there was a review of the trust's investment strategy and performance no less than annually. 37 Misc 3d 875 (N.Y. Sur Ct 2012), *aff'd* 109 A.D.3d 1118 (N.Y. App. Ct. 2013). When the four stocks fell in value as part of an overall market decline in 2001, the trustee decided that it would not be prudent to sell the stocks in a declining market, and that a sale would trigger substantial capital gains taxes. The court found that the record evidenced a well-thought-out and balanced approach to managing the trust assets, and dismissed all of the objections to the account. *Id*.

In *Estate of Trusts*, a beneficiary objected to a trustee's request for a judicial approval of trust accounts on the basis that the trustee failed to diversify trust assets. 2015 NYLJ LEXIS 4202 (N.Y. Sur. Ct. August 10, 2015). The court overruled the objection after considering: (1) the grantor's intent regarding diversification in the trust document; (2) the grantor's intent regarding the investment philosophy by appointing an individual co-trustee; (3) the grantor's intent, as expressed in the power given to the individual co-trustee to remove the corporate trustee at any time and for any reason or for no reason; (4) the grantor's intent, as evidenced by the history of investment of the trusts; (5) the relatively short period of time covered by the accounts, as compared with the long-term investment strategy chosen for the trusts; (6) that the disputed stocks were on the bank's approved list; (7) that bank complied with its own policy of diversification within five years, for high-cap growth investments; and (8) there was an initial review of the trust's investment strategy and an annual review thereafter, including trust profiles setting investment objectives. *Id*.

In *Carter v. Carter*, a remainder beneficiary sued the trustee for investing solely in income-producing tax-free municipal bonds. 2012 Ill. App. 110855, 965 N.E.2d 1146 (Ill. 2012). The plaintiff argued that the trustee breached her fiduciary duty by favoring income over appreciation because the trustee was the income beneficiary. *Id*. The court held that plaintiff failed to establish a claim because there was no evidence that the trustee's decision was "wholly" arbitrary or unreasonable. The court also relied on the trust language that excused the trustee from diversifying assets. *Id*. The court did note that if a trustee invests a concentration of trust assets in its own stock, a case may be made for finding that a trustee's duty of prudence trumps trust language excusing diversification. *Id*.

Therefore, where a court has to determine whether a trustee has complied with its duty of prudence and to diversify, there are many factors that should be considered.

IX. Conclusion

Many individuals in the wealth-preservation industry believe that a trustee has an absolute duty to diversify that cannot be altered. That is not true. There is a general duty to diversify, but where there are special circumstances, a trustee may reasonably decide to not diversify.

Even absent "special circumstances" or in addition thereto, a settlor can relieve a trustee of the duty to diversify assets if the language of the trust is sufficiently clear. This language should be enforceable in Texas least to protect a trustee from actions or inactions that do not involve gross negligence or intentional conduct. Finally, there are other options to protect a trustee from liability due to a duty to diversify.

A professional trustee has risk that is inherent with the position that it holds. Risk associated with the diversification of assets can be minimized. A trustee does not necessarily have to end long-standing relationships and resign because of the perceived risk associated with holding large concentrations of trust assets in a family business, real property, or other asset. However, unless it is done correctly, a trustee can open itself up to unnecessary risk: "In the US, the number of diversification-related lawsuits against trustees is on the rise." Jochen Vogler, *Why Diversify?*, www.step.org/journal (January 2015).

The decision to diversify may mean less risk of claims against the trustee and less regulatory hassle, but it does not mean that the trust will receive a higher rate of return, that the trustee is serving the original intent of the settlor or the purpose of the trust, or that the trustee is judging the needs and wants of the beneficiaries. In that way, diversification may be a simple answer, but it may also be a violation of a trustee's more basic duties.

In one case, a trustee was held grossly negligent for diversifying assets. *In re Sky Trust*, 868 A.2d 464 (Pa. Super. 2005). The beneficiary had a need for income, and the trustee diversified the assets (the trustee's own stock) into more equity based investments and lengthening the investment time horizon. *Id*. The court of appeals affirmed the gross negligence finding: "diversification cannot become a goal in and of itself. Rather, diversification is a tool that can provide the means to effectuate a settlor's goals of a trust, if used properly and prudently with due regard to the specific facts and circumstances that exist in a particular case." *Id*. The trustee's hypothetical strategy did not satisfy its fiduciary duty. *Id.; see also In re Estate of Kettle,* 423 N.Y.S.2d 701 (App. Div. 1979) (trustee breached duty by selling stock).

The author hopes that this article has provided helpful advice on how to maintain client relationships and still meet legal requirements to limit the risk of diversification-related claims.