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Use Of Equitable Defenses In Breach Of Fiduciary Duty Litigation

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A. Introduction

It is not uncommon for beneficiaries to sue a trustee for actions that the beneficiaries had knowledge of but where they failed to object to that conduct for a period of time. In this circumstance, the trustee may want to raise certain equitable defenses to those claims, such as laches, ratification, waiver, and estoppel. Equitable defenses are appropriate for breach of fiduciary duty claims as fiduciary relationships originate in equity. At the core of these equitable defenses is the concept that a party should not be allowed to act inconsistently: have knowledge of conduct and fail to object to it for a period of time (thereby tacitly agreeing to the conduct) and then later raising claims against the trustee for the same conduct.

For example, a beneficiary may claim that the trustee has compensated itself too much. A trust document may not allow for “reasonable compensation,” but have a specific formula or limit on compensation. The trustee may inadvertently use its standard formula for compensation, which was technically too much and over the amount allowed under the trust document. The trustee, however, has disclosed the actual compensation it paid itself on quarterly statements. Later, a beneficiary is in conflict with the trustee and then, for the first time, alleges that the trustee has breached its duties by overcompensating itself. Can the trustee point to the quarterly statements and argue that the beneficiary is not allowed to complain about the overcompensation by waiting to challenge it and by allowing the trustee to continue to do work without objection?

Like all equitable claims and defenses, these defenses largely depend on the facts and circumstances of the case. This note is intended to provide a legal framework for the most common equitable defenses and provide some common arguments to avoid those defenses.

B. Legal Basis for Equitable Defenses

Laches may bar an action where the plaintiff acquiesces in the way and manner a trust is handled for many years. *Garver v. First Nat’l Bank*, 432 S.W.2d 745 (Tex. App.—Amarillo 1968, writ ref’d n.r.e.). The defense of laches requires the establishment of two distinct elements: (1) an unreasonable delay by the moving party in asserting their rights and (2) the person raising the defense must be disadvantaged as a result of this delay by the moving party. *Culver v. Pickens*, 176 SW2d 167 (Tex.

1943); *Knesek v. Witte*, 754 S.W.2d 814, 816 (Tex. App.—Houston [1st Dist.] 1988, writ denied). For example, in *Garver*, a husband and wife filed suit against a bank seeking recovery of an interest in the proceeds of oil and gas leases that had been deposited with the bank for the benefit of the heirs of the wife's parents. 432 S.W.2d at 746. The bank had handled the deposits for many years, as directed by the estate's executors, who were the wife's brothers. The court of appeals affirmed a summary judgment in favor of the bank, holding among other things that the plaintiffs' claims were barred by laches because the plaintiffs had acquiesced in the brothers' handling of the estate's proceeds for a period of nineteen years. 432 S.W.2d at 749. The court held that no one has the right to remain inactive when action is demanded while another party so changes his position that great damage will be inflicted by granting the remedial writ. *Id*. Laches applied to bar such a claim. *Id*.

The elements of ratification are: (1) approval by act, word, or conduct; (2) with full knowledge of the facts of the earlier act, and (3) with the intention of giving validity to the earlier act. *Sandi Samms v. Autumn Run Cmty. Improvement Ass'n.*, 23 S.W.3d 398, 403 (Tex. App.—Houston [1st. Dist.] 2000, pet. denied). In order to prove the intent required for ratification, a party must show that the opposing party, after obtaining knowledge of the facts of the transaction, either (1) continued to accept benefits under the transaction or (2) conducted himself so as to recognize the transaction as binding. *LSR Joint Venture No. 2 v. Callewart*, 837 S.W.2d 693, 699 (Tex. App.—Dallas 1992, writ denied). A ratification may be shown by an express act or word or may be inferred from a party's course of conduct. *Curtis v. Pipelife Corp*., 370 S.W.2d 764, 768 (Tex. Civ. App.—Eastland 1963, no writ). An express ratification is not necessary; any act based on a recognition of the contract as subsisting or any conduct inconsistent with an intention of avoiding it has the effect of waiving the right of rescission. *Rosenbaum v. Tex. Bldg. & Mort. Co*., 140 Tex. 325, 167 S.W.2d 506 (1943); *Newsom v. Starkey*, 541 S.W.2d 468 (Tex. Civ. App.—Dallas 1976, writ ref'd n.r.e.). Any retention of the beneficial part of the transaction affirms the contract and bars an action for rescission as a matter of law. *Daniel v. Goesl*, 161 Tex. 490, 341 S.W.2d 892 (1960). Where a party affirms a contract through his actions and conduct after knowledge of the facts, the defense of waiver or ratification is established as a matter of law. *Id*.

Waiver is defined as an intentional relinquishment of a known right or intentional conduct inconsistent with claiming such right. *Sun Exploration & Prod. Co. v. Benton*, 728 S.W.2d 35, 37 (Tex. 1987). The elements of waiver include the following: (1) existing right, benefit, or advantage; (2) actual or constructive knowledge of its existence; and (3) an actual intent to relinquish the right inferable from the conduct. *Perry Homes v. Cull*, 258 S.W.3d 580, 602–03 (Tex. 2008); *Tenneco Inc. v. Enter. Prods. Co*., 925 S.W.2d 640, 643 (Tex. 1996); *Bass & Co. v. Dalsan Props.—Abilene*, 885 S.W.2d 572, 577 (Tex. App.—Dallas 1991, no writ). A party can impliedly waive the other party's breach where he fails to object to a deviation by the other party from the strict terms of the contract. *Childress v. Cook*, 245 F.2d 798 (5th Cir. 1957). A party may evidence waiver by conduct of such a nature as to mislead the opposite party into an honest belief that the waiver was intended or assented to. *Shaver v. Schuster*, 815 S.W.2d 818 (Tex. App.—Amarillo 1991, no writ). Waiver can be established as a matter of law. *H.A. Lott, Inc. v. Pittsburgh Plate Glass Co*., 432 S.W.2d 583, 586 (Tex. Civ. App.—Amarillo 1968, no writ). Further, the doctrine of waiver is applicable to all rights and privileges to which a person is legally entitled. *Burton v. Nat'l Bank of Commerce*, 679 S.W.2d 115 (Tex. App.—Dallas 1984, no writ).

Estoppel prevents one party who has induced another to act in a particular way from adopting an inconsistent position, attitude, or course of conduct that will cause loss or injury to the other person. *Houtchens v. Matthews*, 557 S.W.2d 581, 585 (Tex. Civ. App.—Fort Worth 1977, writ dism.). The elements of equitable estoppel are: (1) a false representation or concealment of material facts, (2) made with the knowledge, actual or constructive, of those facts, (3) to a party without knowledge,

or the means of knowledge, of those facts, (4) with the intention that it should be acted on, and (5) the party to whom it was made must have relied or acted on it to his prejudice. *Gulbenkian v. Penn*, 151 Tex. 412, 252 S.W.2d 929 (1952). A false representation may be accomplished by conduct, or when one has a duty to speak, by mere silence. *Champlin Oil & Refining Co. v. Chastain*, 403 S.W.2d 376 (Tex. 1965).

Additionally, quasi estoppel is a defense that prevents a party from obtaining a benefit by asserting a right to the disadvantage of another that is inconsistent with the party's previous position. *Vessels v. Anschutz Corp*., 823 S.W.2d 762 (Tex. App.—Texarkana 1992, writ denied). Quasi estoppel refers to conduct such as ratification, election, acquiescence, or acceptance of benefits. *Steubner Realty 19 v. Cravens Road 88*, 817 S.W.2d 160, 164 (Tex. App.—Houston [14th Dist.] 1991, no writ). Further, quasi estoppel may be asserted even though there has been no concealment or misrepresentation on one side, and no ignorance or detrimental reliance on the other side. *Vessels*, 823 S.W.2d at 762. The doctrine applies when it would be unconscionable to allow a person to maintain a position inconsistent with one in which he acquiesced, or of which he accepted a benefit. *Steubner Realty 19*, 817 S.W.2d at 164. One who retains benefits under a transaction cannot avoid its obligations and is estopped to take an inconsistent position. *Vessels*, 823 S.W.2d at 762; *Theriot v. Smith*, 263 S.W.2d 181, 183 (Tex. Civ. App.—Waco 1953, writ dism'd). In other words, a party may not accept the benefits of a transaction and then later take "an inconsistent position to avoid corresponding obligations or effects." *Lindley v. McKnight*, 349 S.W.3d 113, 131 (Tex. App. —Fort Worth 2011, no pet.).

Accord and satisfaction exists when the parties agree to discharge "an existing obligation in a manner other than in accordance with the terms of their original contract." *Avary v. Bank of Am., N.A.,* 72 S.W.3d 779, 788 (Tex. App.—Dallas 2002, pet. denied). The defense involves a new contract, either express or implied, in which the existing obligation is released by agreement of the parties through "means of [a] lesser payment tendered and accepted." *Richardson v. Allstate Tex. Lloyd's,* 235 S.W.3d 863, 865 (Tex. App.—Dallas 2007, no pet.). To establish the affirmative defense of accord and satisfaction, the defendant must show that in the new contract: (1) the parties agree to discharge the existing obligation; (2) the parties agree that one party will perform and the other will accept something different from what each expected from the existing obligation; (3) the parties unmistakably communicate that the different performance will discharge the existing obligation; (4) the agreement to discharge the existing obligation is plain, definite, certain, clear, full, explicit, and not susceptible of any other interpretation; and (5) the parties' agreement must be accompanied by acts and declarations that the creditor is "bound to understand." *Honeycutt v. Billingsley*, 992 S.W.2d 570, 576-77 (Tex. App.—Houston [1st Dist.] 1999, pet. denied) (quoting *Jenkins v. Henry C. Beck Co*., 449 S.W.2d 454, 455 (Tex. 1969)). *See also Collins v. Moroch*, 339 S.W.3d 159, 164 (Tex. App.—Dallas 2011, pet. denied). Critically, the evidence must establish the parties' assent to the new agreement, and "[t]here must be an unmistakable communication to the creditor that tender of the lesser sum is upon the condition that acceptance will constitute satisfaction of the underlying obligation." *Ind. Lumbermen's Mut. Ins. Co. v. State*, 1 S.W.3d 264, 266 (Tex. App.—Fort Worth 1999, pet. denied). *See also Hemink Farms, Ltd. v. BCL Constr., LLC*, No. 07-17-00457-CV, 2019 Tex. App. LEXIS 2209, at *8 (Tex. App.—Amarillo Mar. 20, 2019, pet. denied) ("To show the necessary meeting of the minds, there should be a statement that accompanies the tender of the lesser sum, which statement also must be so clear and so explicit and so complete that the statement is simply not susceptible of any other interpretation but one of complete accord and complete satisfaction." (internal quotations omitted)). Accord and satisfaction can apply to torts as well as breach of contract claims.

C. Recent Case Using Quasi-Estoppel To Dismiss Claims Against A Trustee

In *Goughnour v. Patterson*, a beneficiary sued a trustee based on a failed real estate investment. No. 12-17-00234-CV, 2019 Tex. App. LEXIS 1665 (Tex. App.—Tyler March 5, 2019, pet. denied). In 2007, the trustee of four trusts invited his mother, the primary beneficiary, and his siblings, also beneficiaries, to participate in a real estate investment that he created by allowing the use of trust funds. They all agreed, and the trustee transferred a total of $2.1 million from the four trusts to the real estate investment entity. The project failed, and the trusts lost the $2.1 million. In 2011, the trustee filed suit to resign and obtain a judicial discharge. A sister filed a breach of fiduciary duty claim based on this failed investment.

After a bench trial, the court rendered judgment approving the trust accounting, approving the trustee's administration, and holding that the trustee, individually and in his capacity of trustee, was "completely discharged and relieved of all duties" and was "fully and completely released and discharged from any and all claims, duties, causes of action or liabilities (including taxes of any kind) relating to any and all actions or omissions in connection with his administration of the DPH Trust." *Id*. The court ordered that the successor trustee pay all outstanding legal and accounting fees incurred by the trust, appointed a successor trustee, and relieved the successor trustee of any and all duty, responsibility, or authority to investigate the actions or inactions of the trustee as prior trustee. The court further ordered that the sister take nothing on all her claims and ordered her to pay attorney's fees for the trustee. The sister appealed.

The court of appeals issued a very lengthy and detailed opinion affirming in part and reversing in part the trial court's judgment. The court of appeals affirmed the application of the trustee's affirmative defense of quasi-estoppel based on the beneficiary's prior consent to trust investments in other real estate investments:

> The affirmative defense of quasi-estoppel precludes a party from asserting, to another's disadvantage, a right inconsistent with a position she has previously taken. The doctrine applies when it would be unconscionable to allow a party to maintain a position inconsistent with one in which she acquired or by which that party accepted a benefit. The record shows that Robert initiated approximately fifty real estate transactions in which he invested Trust assets. Deborah agreed to all of these transactions. All transactions except Bighorn were successful and the Trust benefitted from those prior investments. Therefore, Deborah's claims for breach of fiduciary duty are barred by the affirmative defense of quasi-estoppel.

Id. (internal citations omitted).

D. Potential Arguments To Defeat Equitable Defenses

Beneficiaries may argue that the trustee did not prove all of the elements if the equitable defenses set forth above. Also, the beneficiaries may also argue other theories prevent the use of the equitable defenses.

Beneficiaries may argue that the trustee has acted with unclean hands and therefore may not take advantage of equitable defenses. Equitable theories, such as estoppel, waiver, and ratification, are subject to traditional equitable defenses. *In re EGL Eagle Global Logistics, LP*, 89 S.W.3d 761, 766 (Tex. App.—Houston [1st Dist.] 2002, orig. proceeding). The clean-hands doctrine is "[t]he principle

that a party cannot seek equitable relief or assert an equitable defense if that party had violated an equitable principle, such as good faith. . . . Such party is described as having 'unclean hands.'" *Design Elec. v. Cadence McShane Corp*., No. 14-06-00703-CV, 2007 Tex. App. LEXIS 8586, at *45 (Tex. App.—Houston [14th Dist.] Oct. 30, 2007). Equitable relief is not warranted when the party seeking relief has engaged in unconscionable, unjust, or inequitable conduct with regard to the issue in dispute. *Dunnagan v. Watson*, 204 S.W.3d 30, 41 (Tex. App.—Fort Worth 2006, pet. denied); *see also Flores v. Flores*, 116 S.W.3d 870, 876 (Tex. App.–Corpus Christi 2003, no pet.) ("The doctrine applies against a litigant whose own conduct in connection with the same matter or transaction has been unconscientious, unjust, marked by a want of good faith, or violates the principles of equity and righteous dealing."). Thus, when seeking an equitable remedy, a party must do equity and come to the court with clean hands. *Adams v. First Nat. Bank of Bells/Savoy*, 154 S.W.3d 859 (Tex. App.—Dallas 2005, no pet.); *In re EGL*, 89 S.W.3d at 766; *Texas Enters., Inc. v. Arnold Oil Co*., 59 S.W.3d 244, 249 (Tex. App.—San Antonio 2001, no pet.); *Breaux v. Allied Bank*, 699 S.W.2d 599, 604 (Tex. App.—Houston [14th Dist.] 1985, writ ref'd n.r.e.). The doctrine of estoppel, including quasi-estoppel, is designed to protect the innocent; thus, a party may not urge this defense as a shield against its own tortious acts. *Stimpson v. Plano ISD*, 743 S.W.2d 944, 946 (Tex. App.—Dallas 1987, writ denied); *Brodrick Moving & Storage Co. v. Moorer*, 685 S.W.2d 75, 77 (Tex. App.—Beaumont 1984, writ ref'd n.r.e.).

More specifically, to invoke equitable doctrines such as estoppel, waiver, or ratification the defendant must come with "clean hands." *Ford Motor Co. v. Motor Vehicle Bd*., 21 S.W.3d 744, 758 (Tex. App.—Austin 2000, pet. denied) (estoppel); *Texas Workers' Compensation Ins. Facility v. Personnel Servs., Inc.,* 895 S.W.2d 889, 894 (Tex. App.—Austin 1995, no writ) (estoppel); *Pickett v. Heygood, Orr & Reyes, L.L.P*., No. 05-07-00079-CV, 2008 Tex. App. LEXIS 4048, 2008 WL 2266133, at *5 (Tex. App.—Dallas Jun. 4, 2008, no pet.) (mem. op.) (quasi-estoppel); *Spangler v. Jones*, 861 S.W.2d 392, 397-98 (Tex. App.—Dallas 1993, writ denied) (ratification). For example, in *Bank of Am., N.A. v. Prize Energy Res., L.P.,* 510 S.W.3d 497, 505 (Tex. App.—San Antonio 2014, pet. denied), a court found that a trustee was not barred from challenging an oil and gas lease under an equitable ratification theory by accepting royalty payments. Specifically, the court considered the defendant's argument that the trustee was precluded from recovery under the defense of equitable estoppel, and held that it could not conclude, "that as a matter of law, [the defendants] came to the table with clean hands and [were] entitled to raise the equitable defense of quasi-estoppel." *Id*. at 513.

Beneficiaries may argue that they were compelled to accept the trustee's improper conduct and that their acceptance was not voluntary. Where one party's tortious conduct has placed the other party in a position of forced conduct—i.e. where the tortious conduct leaves the innocent party with no real choice but to act in a manner consistent with the tortious conduct, the innocent party's actions do not constitute ratification of the tortious conduct. *See Vessels v. Anschutz Corp.*, 823 S.W.2d 762, 765 (Tex. App.—Texarkana 1992, writ denied). *See also Herider Farms-El Paso, Inc. v. Criswell,* 519 S.W.2d 473, 477-78 (Tex. Civ. App.—El Paso 1975, writ ref'd n.r.e.) (implicitly holding that, by selling his business, plaintiff did not ratify the tortious conduct that put him in the position of having to sell it). For example, in *Vessels*, the court overturned summary judgment on the defendant's defense of ratification. 823 S.W.2d at 765. The plaintiffs had agreed to be bound by the terms of a mineral lease following the settlement of a lawsuit with the FDIC. *Id.* at 764. However, it was the defendants' tortious conduct which placed the plaintiffs in a position of either having to accept the lease or else lose the property. *Id.* at 765. Specifically, the court found "[i]n this case, by agreeing to be bound by the lease, [plaintiffs] did not ratify the tortious conduct that cause them to have to accept the lease or else lose the property. Summary judgment should not have been granted on the basis of ratification." *Id.*

The Beneficiaries may argue that they did not know all of the material facts to make an informed decision in accepting the trustee's conduct and/or they were misled by untrue statements by the trustee. It is well settled that "there can be no ratification or waiver from the acceptance of benefits by a person who did not have knowledge of all material facts." *Byrd v. Woodruff*, 891 S.W.2d 689, 699-700 (Tex. App.—Dallas 1994, writ dism'd) (citing *Frazier v. Wynn*, 472 S.W.2d 750, 753 (Tex. 1971)). Ratification occurs when a person who knows all the material facts confirms or adopts a prior act that did not then legally bind him and which he could have repudiated. *K.B. v. N.B*., 811 S.W.2d 634, 638 (Tex. App.—San Antonio 1991, writ denied). Further, waiver is largely a question of intent. *Vessels*, 823 S.W.2d at 765. "There can be no waiver unless so intended by one party and so understood by the other." *Id*. (citing *Loggins v. Gates*, 301 S.W.2d 525, 527 (Tex. Civ. App.—Waco 1957, writ ref'd n.r.e.). Thus, to find waiver through a party's conduct, intent must be clearly demonstrated by the surrounding facts and circumstances. *Van Indep. Sch. Dist. v. McCarty*, 165 S.W.3d 351, 353 (Tex. 2005). The Texas Supreme Court stated:

> [A]cts done in affirmance of the contract can amount to a waiver of the fraud only where they are done with full knowledge of the fraud and of all material facts, and with the intention, clearly manifested, of abiding by the contract and waiving all right to recover for the deception. Acts which, although in affirmance of the contract, do not indicate any intention to waive the fraud, cannot be held to operate as a waiver.

Fortune Prod. Co. v. Conoco, Inc., 52 S.W.3d 671, 677 (Tex. 2000) (quoting *Kennedy v. Bender*, 104 Tex. 149, 135 S.W. 524, 525 (Tex. 1911)) (internal quotation marks omitted). While waiver may be inferred from conduct, waiver by implication should not be inferred contrary to the intention of the party whose rights would be injuriously affected thereby, unless the opposite party has been misled to his or her prejudice. *Cecil Pond Constr. Co. v. Ed Bell Invs*., 864 S.W.2d 211, 215 (Tex. App.—Tyler 1993, no writ). Furthermore, the acceptance of benefits of an agreement or contract cannot, as a matter of law, preclude a party from challenging the agreement if the party was led into the agreement by virtue of fraud or similar misconduct. *In re Marriage Stroud,* 376 S.W.3d 346, 356-57 (Tex. App.—Dallas 2012, pet. denied). For example, in *In Re Marriage Stroud*, the wife accepted benefits of the terms of a divorce settlement, which she later sought to challenge in court. *Id*. at 350-51. The husband argued that she was estopped from pursuing such action, under the doctrines of both judicial estoppel and quasi-estoppel, as she had accepted benefits of the divorce settlement. *Id*. at 356. However, the wife submitted evidence that she was led into the agreement by the husband's fraud and threats. *Id*. at 357. The court therefore concluded the husband was not entitled to summary judgment on his affirmative defense of estoppel, whether couched in terms of judicial or quasi-estoppel. Specifically:

> The same evidence that created a fact issue as to [the husband's] extrinsic fraud precludes a finding that [he] conclusively proved his affirmative defense of estoppel, whether couched in terms of judicial or quasi-estoppel. Specifically, [the wife's] summary-judgment evidence that her approval and acceptance of the terms of the settlement were the product of [the husband's] threats and misrepresentations creates fact issues as to the validity of her acceptance of benefits and representations in the documents she signed.

Id. See also DeCluitt v. DeCluitt, 613 S.W.2d 777, 781 (Tex. App.—Waco 1981, writ dism'd) (petitioner's affidavit created fact issue on whether she accepted the benefits due to financial need and duress precluding summary judgment on estoppel).

E. Conclusion

There are very few hard-and-fast rules in fiduciary litigation, and there is a lot of gray area. The use and application of equitable defenses are perfect examples of this gray area. Beneficiaries should not generally be allowed to lay behind the log, have knowledge of a trustee's conduct, not object to such conduct for a period of time, and then later complain in litigation of that conduct. However, there may be other facts and circumstances that may justify a beneficiary in waiting to complain and that may defend against a trustee using equitable defenses. Sometimes, the application or inapplication of equitable defenses can be proven as a matter of law by a judge; but more often, these defenses will have be resolved by a fact finder (by a judge, or if requested, by a jury).

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