NO. C-1-PB-14-001245

IN RE:	§	IN THE PROBATE COURT
	§	
	§	NO. 1 OF
	§	
TEL OFFSHORE TRUST	§	TRAVIS COUNTY, TEXAS

INDIVIDUAL TRUSTEES' SPECIAL EXCEPTIONS AND PLEA TO THE JURISDICTION

Gary C. Evans, Jeffrey S. Swanson, and Thomas H. Owen, Jr., as Individual Trustees (collectively, "Trustees") of the TEL Offshore Trust ("Trust"), specially except to, and plead to the jurisdiction with respect to, the First Amended Counterclaim ("FAC") filed on August 17, 2016 by Glenn M. Karisch ("Ad Litem") as set forth below.

I. INTRODUCTION

The FAC is an unprecedented and legally impermissible attempt to end-run settled Texas law on representative actions. The Ad Litem is purporting to bring his claims "derivatively on behalf of the TEL Offshore Trust and all of its beneficiaries,"[1] which includes thousands of unitholders in a publicly-traded entity. The Trustees specially except and plead to the jurisdiction because: (i) Texas law prohibits beneficiaries from suing derivatively on behalf of a trust; and (ii) Texas law does not permit the Ad Litem to sue in a representative capacity on behalf of thousands of public unitholders.[2] The Trustees also adopt and join the Special Exceptions asserted by the Corporate Trustee.

[1] FAC p. 1 (introduction paragraph).

[2] The special exceptions are also asserted as pleas to the jurisdiction because the Ad Litem has no legal standing to assert these claims. Standing is jurisdictional. *See, e.g., M.D. Anderson Cancer Ctr.* v. *Novak*, 52 S.W.3d 704, 710 (Tex. 2001) ("Because the Texas Constitution requires the presence of a proper party to raise issues before the Court, standing is a threshold inquiry . . . ."); *Tex. Ass'n of Bus.* v. *Tex. Air Control Bd.*, 852 S.W.2d 440, 446 (Tex. 1993) (standing is a question of subject-matter jurisdiction).

Texas appellate courts strongly disfavor representative actions on behalf of unitholders or shareholders and regularly grant relief when an individual holder is wrongfully permitted to bring fiduciary duty claims against trustees or directors in a representative capacity, with special exceptions being the preferred procedural vehicle for litigating these issues.[3] The Ad Litem similarly lacks authority to bring the representative claims asserted in this case. Allowing this case to proceed beyond the pleading stage under these circumstances would create the same irreparable harm addressed in the numerous appellate cases cited in footnote 3.

II.
ARGUMENT

A. Special Exception and Plea to the Jurisdiction #1: The Ad Litem Cannot Sue Derivatively on Behalf of the Whole Trust

The Trustees specially except to, and plead to the jurisdiction with respect to, the TAC as a whole (and, without limitation, the opening paragraph and paragraphs 2 and 3 therein and all claims for relief) because Texas law does not permit beneficiaries to file derivative claims against trustees on behalf of a trust. In a derivative claim, a unitholder purports to step into the entity's shoes and bring claims on behalf of the entire entity. Texas law prohibits derivative claims by trust beneficiaries. *See In re XTO Energy Inc.*, 471 S.W.3d 126, 137 (Tex. App.—Dallas 2015, orig. proceeding) ("[W]e have found no Texas case authority allowing a trust

[3] *E.g., In re XTO Energy Inc.*, 471 S.W.3d 126, 137 (Tex. App.—Dallas 2015, orig. proceeding) (granting mandamus where derivative claims by royalty trust unitholders were wrongfully allowed to proceed beyond special exceptions); *In re Astrotech Corp.*, No. 03-13-00624, 2014 WL 711018, at *2 (Tex. App.—Austin Feb. 14, 2014, orig. proceeding) (granting mandamus where derivative suit wrongfully allowed to proceed); *In re Helix Energy Solutions Group, Inc.*, 440 S.W.3d 167, 176-78 (Tex. App.—Houston [14th Dist.] 2013, orig. proceeding) (granting mandamus where district court failed to dismiss shareholder derivative case; summary judgment thereafter granted); *In re Brick*, 351 S.W.3d 601, 604 (Tex. App.—Dallas 2011, orig. proceeding) (granting mandamus for failing to sustain special exceptions in Delaware shareholder derivative suit); *In re Denbury Res. Inc.*, No. 05-09-01206-CV, 2009 WL 4263850 at *2 (Tex. App.—Dallas Dec. 1, 2009, orig. proceeding) (same); *In re Schmitz*, 285 S.W.3d 451 (Tex. 2009) (granting mandamus in derivative case where dismissal on pleadings improperly denied); *In re Crown Castle Int'l Corp.*, 247 S.W.3d 349, 355 (Tex. App.—Houston [14th Dist.] 2008, orig. proceeding) (granting mandamus where district court allowed discovery in violation of Delaware law).

beneficiary to sue a trustee derivatively on behalf of the trust."); *Ray Malooly Trust v. Juhl*, 186 S.W.3d 568, 570 (Tex. 2006) (trusts are not legal entities and may not sue or be sued).

The Trust Code instead gives ***trustees*** the exclusive power to "compromise, arbitrate, or settle claims of or against the trust estate or the trustee." TEX. PROP. CODE ANN. § 113.019; *see also H.E.Y. Trust v. Popcorn Express Co.*, 35 S.W.3d 55, 60 n.5 (Tex. App.—Houston [14th Dist.] 2000, pet. denied) (discussing trustee's statutory authority to assert claims on behalf of the trust). And indeed, the Trust Agreement for TEL Offshore vests the Corporate Trustee and Individual Trustees with the exclusive authority to maintain, defend, and settle lawsuits by or against the Trust. Trust Agreement § 6.11.

Texas law thus does not allow individual beneficiaries to sue in a representative capacity on behalf of the entire trust against a trustee. The Ad Litem's allegation that he is suing "derivatively on behalf of the TEL Offshore Trust" is thus improper. This is a legal defect that cannot be cured by amendment, so the Court need not allow an amended petition. *See Baylor Univ. v. Sonnichsen*, 221 S.W.3d 632, 635 (Tex. 2007) (holding that courts need not allow an opportunity to amend if defect is incurable); *In re XTO*, 471 S.W.3d at 137 (same). The Trustees thus pray that the Court dismiss with prejudice all claims in the TAC that are asserted derivatively on behalf of the Trust. In the alternative, the Trustees request that the Court sustain this special exception and require the Ad Litem to replead claims that comply with Texas law.

B. <u>Special Exception and Plea to the Jurisdiction #2: The Ad Litem Cannot Sue the Trustees on Behalf of Thousands of Absent Beneficiaries</u>

The Trustees also specially except to, and plead to the jurisdiction with respect to, the TAC as a whole (and, without limitation, the opening paragraph and paragraphs 2 and 3 therein and all claims for relief) because Texas law does not permit the Ad Litem to sue the Trustees in a representative capacity on behalf of "all of [TEL Offshore Trust's] beneficiaries" as asserted in

the Petition (or on behalf of the approximately 3,000 beneficiaries who were served by publication). This is simply a repackaging of the Ad Litem's impermissible derivative claim on behalf of the Trust. *See In re XTO*, 471 S.W.3d at 137. There is no functional difference between a claim asserted on behalf of the whole Trust and one asserted collectively on behalf of "all of its beneficiaries." *See Ford v. Bimbo Corp.*, 512 S.W.2d 793, 795 (Tex. App.—Houston [14th Dist.] 1974, no writ) ("All derivative actions are brought on behalf of other shareholders similarly situated . . . ."). Indeed, the FAC specifically uses the word "derivatively" to describe the capacity in which the Ad Litem purports to be suing. If a single beneficiary or ad litem could sue on a classwide basis, the holding in *XTO* would be rendered meaningless.

Numerous other well-enshrined concepts in Texas law confirm that the Ad Litem cannot sue the Trustees representatively on behalf of thousands of absent unitholders.

First, trust law simply does not contemplate or permit class-style representative actions against trustees. While the Restatement "states that a person may bring suit on behalf of other beneficiaries, the comments to section 94 (of the Restatement) make it clear that this is only the case when the person is acting as a fiduciary, ***such as when the beneficiary being represented is under an incapacity***." *See XTO*, 471 S.W.3d at 137 (citing Restatement (Third) of Trusts § 94)).

There is no assertion that the beneficiaries have any "incapacity" that would permit a representative action. The relevant comment to Section 94 states as follows:

> *d. Others acting on behalf of beneficiaries.* If a beneficiary is ***under an incapacity***, suit may be brought against a trustee ***on behalf of that beneficiary*** by a ***personal*** fiduciary (conservator, natural or legally appointed guardian, or the like, or an agent so empowered under a durable power of attorney).

Restatement (Third) of Trusts § 94, cmt. d.

The Ad Litem has not alleged and cannot plausibly show that each or any of the 6,500 unitholders are under any legal "incapacity." Under Texas law, an "incapacitated person" is:

"(1) a person who is mentally, physically, or legally incompetent; (2) a person who is judicially declared incompetent; (3) an incompetent or an incompetent person; (4) a person of unsound mind; or (5) a habitual drunkard." TEX. ESTATES CODE § 1001.003 (stating that this definition applies "[i]n this code or any other law"). Simply being absent or being served by publication does not equate to a legal "incapacity" under Section 1001.003's plain language.

Moreover, the reference to a "legally appointed guardian" in comment d further compels the conclusion that an ad litem cannot sidestep the prohibition on representative actions against trustees by claiming to directly represent each absent unitholder. As stated in the comment, a "legally appointed guardian" may only sue trustees on behalf of a beneficiary when that beneficiary is "under an incapacity." If an ad litem was considered a direct representative of all 6,500 beneficiaries for purposes of comment d, the reference to the appointment of a "legally appointed guardian" would be superfluous, and the "incapacity" requirement would disappear.

The list of "personal fiduciaries" in comment d likewise confirms that the Restatement (Third) of Trusts does not contemplate or permit class-style representative claims. The words "conservator," "natural" guardian, and "agents empowered under a durable power of attorney" connote ***personal*** situations where a beneficiary's decisionmaking authority is delegated on a ***highly individualized*** basis. Conservatorships, natural guardians and durable powers of attorney simply do not involve mass-representation situations. To confer mass-representation capabilities on "legally appointed guardians" would be inconsistent with the personalized fiduciary relationships contemplated in the other categories listed (and indeed, the comment describes these categories as "***personal*** fiduciaries"). *See Churchill Forge, Inc. v. Brown*, 61 S.W.3d 368, 372 (Tex. 2001) (construing categories by examining nature of other categories in a series).

Construing the ad litem statute to permit class-like representative claims against trustees on behalf of thousands of absent unitholders would also improperly usurp the Trustees' judgment about whether claims impacting all or a substantial part of the Trust should be pursued. As stated above (pp. 2-3), the Trust Code and the Trust Agreement give the ***Corporate Trustee and Individual Trustees*** the exclusive power to make litigation decisions on behalf of the Trust. Conferring class-style representative status on the Ad Litem would improperly usurp this right.

Second, even assuming *arguendo* that class claims could potentially be appropriate in the trust context,[4] the ad litem statutes do not contemplate or permit class-style claims by an ad litem and contain only generalized provisions that must give way to the specific requirements for class claims – which the Ad Litem is plainly incapable of satisfying. The "service by publication" rule (Tex. R. Civ. P. 244) only authorizes an ad litem "to ***defend*** the suit," not to pursue affirmative class-style claims. TEX. R. CIV. P. 244. The ad litem provisions under Section 53.104 of the Texas Estates Code (which allows ad litems to "represent the interests of any person") and Section 115.014 of the Property Code (which allows appointment of ad litems "to represent the interest of a minor, an incapacitated, unborn, or unascertained person, or person whose identity or address is unknown, if the court determines that representation of the interests otherwise would be inadequate") are similarly generic and say nothing about allowing an ad litem to bring suit seeking affirmative relief in absentia for thousands of public unitholders.

By contrast, Texas law (including Tex. R. Civ. P. 42) imposes numerous specific requirements for class actions on behalf of large numbers of absent parties, including requirements of adequate representation, commonality, typicality and predominance. This rule applies in probate court. *See* TEX. ESTATES CODE § 53.107 (providing that certain civil

[4] As set forth above, a class or representative action is not permissible under the circumstances alleged in this case.

procedure rules – but not Rule 42 – are inapplicable in probate court). Texas appeals courts zealously police the requirements for class certification and require trial courts to "perform a 'rigorous analysis' before ruling on class certification to determine whether all prerequisites to certification have been met." *Southwestern Ref. Co. v. Bernal*, 22 S.W.3d 425, 435 (Tex. 2000).

The specific requirements for class actions, as well as the overall scheme of court-imposed requirements for such cases, would be frustrated if the ad litem statutes were construed as a backdoor vehicle for class action claims. It is a settled rule of construction that the specific controls over the general. *See Horizon/CMS Healthcare Corp. v. Auld*, 34 S.W.3d 887, 901 (Tex. 2000) (describing "traditional statutory construction principle that the more specific statute controls over the more general"). To the extent class actions on behalf of thousands of absent unitholders are permissible at all,[5] the specific requirements for class actions should control over the general provisions regarding ad litems. Moreover, when considering an individual rule or provision, courts "must consider its role in the broader statutory scheme." *20801, Inc. v. Parker*, 249 S.W.3d 392, 396 (Tex. 2008). Allowing the Ad Litem to bring these unprecedented claims in a representative capacity would frustrate the well-established scheme for class actions set forth in the Texas Rules of Civil Procedure and under Texas law.

Assuming *arguendo* that a class-like claim could be permissible in this context, the Ad Litem pleads no facts showing that any of the requirements for bringing a class action are capable of being satisfied. Most fundamentally, a class action may only be filed by "[o]ne or more members of a class. . . ." TEX. R. CIV. P. 42. Rule 42 requires an actual ***class***

[5] The Trustees do not believe such actions are permissible. *See In re XTO Energy Inc.*, 471 S.W.3d 126, 137 (Tex. App.—Dallas 2015, orig. proceeding) ("[W]e have found no Texas case authority allowing a trust beneficiary to sue a trustee derivatively on behalf of the trust."). The Restatement (Third) of Trusts does not permit class-style claims against trustees. But even if representative actions like this were permissible, they would be subject to Rule 42, which the Ad Litem has not met and cannot meet.

representative and does not permit lawyers to file class actions without client oversight. *See Forsyth v. Lake LBJ Inv. Corp.*, 903 S.W.2d 146, 150-51 (Tex. App.—Austin 1995, writ dism'd w.o.j.) (describing adequacy factors such as "the personal integrity of the plaintiffs," their "familiarity with the litigation" and their "belief in the legitimacy of the grievance"). The class is entitled "'to more than competent counsel. It must also be assured that it will have an adequate representative, ***one who will check the otherwise unfettered discretion of counsel in prosecuting the suit*** and who will provide his personal knowledge of the facts underlying the complaint . . . . Plaintiff's evident willingness to rely on counsel's ability to protect the interests of the class is inconsistent with the participation required of an adequate class representative.'" *Id.* at 152 (quoting *Weisman v. Darneille*, 78 F.R.D. 669, 671 (S.D.N.Y. 1978)) (emphasis added). Thus, even assuming *arguendo* that a class could be brought, the Ad Litem's claims must be dismissed or repled because the FAC does not identify a class representative.

Nor can the Ad Litem plausibly satisfy the other requirements for certifying a class. With no actual client, the Ad Litem cannot show that his claims are typical of other beneficiaries or are devoid of unique defenses. The Ad Litem also faces an irreconcilable conflict with unitholders who do not want the Trust assets wasted on this lawsuit, which is a pressing concern given the Ad Litem's demand that he be paid from Trust assets. Class claims are improper when, as here, there is a clear prospect for conflicts between class members. *See Supportkids, Inc. v. Morris*, 167 S.W.3d 422, 426 (Tex. App.—Houston [14th Dist.], pet. dism'd w.o.j.) (finding conflict where plaintiff sought to void contracts on classwide basis when "[t]he chance remains, however, that customers of Supportkids do not want their contracts to be declared void . . . .").

Any class claim would also face insuperable predominance and ascertainability problems. For example, the Ad Litem purports to sue on behalf of all current beneficiaries regardless of

whether they bought their units before or after the alleged wrongdoing. Beneficiaries who bought after the alleged wrongdoing would have no claim. *See Brigham Exploration Co. v. Boytim*, No. 03-015-00248-CV, 2016 WL 3390287, at *5-6 (Tex. App.—Austin June 15, 2016, no pet. h.) (certification of class improper where class definition "lumps together" persons with potential claims and persons with no standing).

The Court should thus sustain the Trustees' special exceptions and plea to the jurisdictions. Improper class claims may be struck or dismissed on the pleadings when, as here, they plainly fail to establish a basis for bringing the suit as a class. *See Boyer v. Diversified Consultants, Inc.*, 306 F.R.D. 536, 540 (E.D. Mich. Apr. 20, 2015) (granting motion to strike class allegations from pleading); *Kraetsch v. United Service Automobile Assoc.*, No. 4:14-CV-264-CEJ, 2015 WL 1457015, at *5 (E.D. Mo. Mar. 30, 2015) (striking class claims at pleading stage where common issues failed to predominate). Even assuming *arguendo* that a class claim could be brought against a trustee (which, as stated above, is impermissible), the Court should sustain Defendants' special exceptions and dismiss the claims or require repleading.

Third, by purporting to sue on behalf of "all" beneficiaries, the Ad Litem is exceeding the authority conferred by the Court's appointment order, which stated that the Ad Litem is appointed only "to represent the interests of the Unit Holders of the TEL Offshore Trust ***who were served by publication, and did not answer or appear***." Of the approximately 6,500 unitholders, completed returns of service were filed for more than 3,600 as of the date of the appointment order. Despite this limitation, the Ad Litem purports to file his counterclaim "derivatively on behalf of [the Trust] and ***all of its beneficiaries***," including those who were served by means other than publication. The Ad Litem has no authority to represent

beneficiaries who were not served by publication or who filed answers. The Ad Litem therefore fails to state and cannot state a claim on behalf of all beneficiaries of the Trust.

Fourth, the Ad Litem does not and cannot plead that he has authority to bring this case because of the near-certain conflict with beneficiaries who do not want this suit pursued. Section 115.014 of the Property Code only allows an ad litem to represent more than one person "if there is not a conflict of interests . . . ." The Ad Litem has failed to establish the absence of a conflict between unitholders who support this claim and unitholders who do not want the Trust funds gambled away on this counterclaim. Again, in applying the similar rule against certifying class actions where a potential conflict exists, courts have placed the onus on the party seeking to represent multiple absent parties to demonstrate the absence of a conflict. *See Supportkids*, 167 S.W.3d at 426 (finding conflict where plaintiff sought to void contracts on classwide basis when "[t]he chance remains, however, that customers of Supportkids do not want their contracts to be declared void . . . ."). Because it is implausible that all absent unitholders are similarly situated and support this lawsuit, the Ad Litem has no authority to bring these claims on their behalf.

Accordingly, Texas law does not permit an ad litem to pursue class-like claims against trustees. Because this is a legal defect that cannot be cured, the Court should dismiss the claims in their entirety. Alternatively, the Court should require the Ad Litem to replead his petition to eliminate all impermissible claims.

III.
CONCLUSION

For the reasons set forth above, the Court should sustain the Trustees' special exceptions and plea to the jurisdiction, dismiss the First Amended Counterclaim in its entirety or, alternatively, require the Ad Litem to replead to eliminate all impermissible claims.

Respectfully submitted,

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CERTIFICATE OF CONFERENCE

I hereby certify that, on the afternoon of September 23, 2016, I contacted Dan Bitting, counsel for the Ad Litem, and asked him whether he consents to or opposes the relief sought herein. I did not receive a response as of the time of filing.

/s/ *Peter A. Stokes*
Peter A. Stokes

CERTIFICATE OF SERVICE

I hereby certify that, on September 23, 2016, a true and correct copy of the foregoing has been served on all interested parties in this matter in accordance with the Court's Order Directing Method of Service dated January 21, 2016.

/s/ *Peter A. Stokes*
Peter A. Stokes