

**NO. C-1-PB-14-001245**

**In Re:** § **In the Probate Court No. 1**  
§  
§ **of**  
§  
**TEL Offshore Trust** § **Travis County, Texas**

**Attorney Ad Litem’s Original Petition as Realigned Plaintiff**

Glenn M. Karisch (“Ad Litem”), as attorney ad litem for the unit holders of TEL Offshore Trust (the “Trust”) who were served by publication and did not answer or appear in this proceeding files this Original Petition as Realigned Plaintiff. All conditions precedent to the assertion of the claims and recovery of the relief below have occurred or have been waived.

**I. Parties**

A. Plaintiff

1. Plaintiff is Glenn M. Karisch, as attorney ad litem for the Unit Holders of the TEL Offshore Trust who were served by publication and did not answer or appear in this proceeding (“Ad Litem”). Ad Litem has appeared herein.

B. Defendants

2. Bank of New York Mellon Trust Company, N. A. (“BONY”), as Corporate Trustee of the TEL Offshore Trust (“Corporate Trustee”), has appeared herein.

3. Jeffrey S. Swanson (“Swanson”) as trustee of the TEL Offshore Trust, has appeared herein.

4. Gary C. Evans (“Evans”) as trustee of the TEL Offshore Trust has appeared herein.

5. Thomas H. Owen, Jr. (“Owen”) as trustee of the TEL Offshore Trust, has appeared herein.

6. Danny Conwill (“Conwill”) as former trustee of the TEL Offshore Trust. Ad Litem will ask for Conwill to be served with citation when he obtains his address.

7. BONY, Swanson, Evans, Owen and Conwill together will be referred to as “Trustees.”

## **II. Jurisdiction, Venue and Discovery Control Plan**

8. Ad Litem seeks damages within the jurisdictional limits of this Court. Jurisdiction in this Court is proper under Sections 32.006 and 32.007 of the Texas Estates Code and under Sections 112.054, 113.151 and 115.001 of the Texas Trust Code. Venue is proper in Travis County because there is a corporate trustee and the situs of administration of the Trust is maintained in Travis County or has been maintained in Travis County at any time during the four-year period before the date the Petition was filed.

9. In their Petition, the Trustees stated that discovery in this action is intended to be conducted under Level 2 in accordance with Texas Rule of Civil Procedure 190.3. Consistent with the Court’s order, Ad Litem expects to reach an agreement on a Level 3 discovery control plan with the other parties.

## **III. Facts**

10. In September 2008 Hurricane Ike greatly damaged the oil and gas properties that were the source of virtually all of the Trust’s income. By failing to take appropriate action within a reasonable time of this damage, the Trustees benefited themselves personally but caused the trust estate millions of dollars in damages. These damages include the steady decline in the value of the Trust’s property and millions of dollars in administrative expenses charged to the Trust. The Trustees received more than \$1,000,000 in compensation during this period while the Trust’s beneficiaries received nothing. Through their negligence, gross negligence, reckless

indifference, bad faith and intentional conduct, the Trustees have breached their fiduciary duties and should be held liable.

A. Before 2009 the revenues from the Trust's main asset—a 25% net profits interest in offshore oil and gas properties—were sufficient to pay administrative expenses and provide substantial distributions to the Beneficiaries.

11. The Trust was created by trust agreement (the “Trust Agreement” or “Agreement”) dated January 1, 1983, by and between Tenneco Offshore Company, Inc., acting on behalf of the owners of units as trustor and Texas Commerce Bank National Association, Horace C. Bailey, Joseph C. Broadus and F. Arnold Daum as original trustees. The Trustees are successors to the original trustees. Conwill served through 2009; Owen replaced him in 2010. The Agreement has not been amended and is irrevocable.

12. The principal asset of the Trust is a 99.99% interest in the TEL Offshore Trust Partnership (the “Partnership”). Chevron U.S.A., Inc. (“Chevron”) owns the other 0.01% interest in the Partnership and operates the Partnership. The beneficiaries of the Trust (the “Beneficiaries”) hold units in the Trust which are publicly traded securities.

13. The Partnership's principal asset is a net profit interests (the “Net Profits Interest”) in oil and gas properties (the “Royalty Properties”) located offshore of Louisiana. Chevron operates some of the Royalty Properties.

14. The Trust's Net Profits Interest is burdened by a share of the Partnership's operating and production costs (“operating costs”). In addition, the Trust has significant general and administrative expenses, including Trustee compensation, attorney's fees and accountant fees (“administrative expenses”).

15. Historically, the Trustees reserved a portion of royalty income from the trust estate to provide funds to pay administrative expenses. The Trustees determined that the reserve

amount should be three times the yearly average of the Trust administrative expenses over the last three years, making it sufficient to cover approximately three years of Trust administrative expenses.

16. The Trustees did not have to pay the Trust's share of operating costs from the trust estate. Rather, those costs were deducted from the Trust's share of revenue under its net profits interest. But in months when the Trust's share of the losses exceeded its share of the revenues, the loss deficit was carried forward to the next month, creating a net loss carryforward. The losses would continue to be carried forward until they were reimbursed by revenues.

17. Finally, the general partner, Chevron, as operator of many of the properties, maintained a special cost escrow account to set aside money for future capital expenditures, like plugging and abandoning wells.

18. In sum, before 2009 the Trust and the Partnership operated in this manner:

- a. Oil and gas production from the Royalty Properties generated income to the Partnership through its net profits interest;
- b. Some of the income paid the Partnership's share of operating costs;
- c. Some of the income paid the Trust's administrative expenses;
- d. Some of the income was held in reserve for future administrative expenses; and
- e. Excess income was distributed to the Beneficiaries.

19. The operator of the Royalty Properties did not explore for new production. The engineers that the Trust hired never identified any unproven reserves or different formations that might be productive. Rather, the operator produced oil and gas from existing, proven reserves that had been producing since the 1970s. Production from all oil and gas properties declines

over time and eventually ceases. Inevitably, the Trustees would have to decide when to pull the plug and maximize the benefit to Beneficiaries by selling the Net Profits Interest. By 2007, all but eight of the Royalty Properties had stopped production. Still, through 2008, the annual distributions to the Beneficiaries were significant. For example, in 2008 the Trust distributed \$13,298,654 to Beneficiaries, or \$2.80 per unit. That all changed after Hurricane Ike.

- B. In September 2008, Hurricane Ike destroyed the property generating around half of the Trusts' income (Eugene Island 339) and delayed revenues from the property generating the other half of revenues (Ship Shoal), altogether eliminating distributions.

20. Of the six Royalty Properties still in production in 2008, two contributed more than 98.5% of the Trust's revenues: Eugene Island 339 and Ship Shoal 182/183. In the third quarter of 2008, for instance, both Eugene Island 339 and Ship Shoal 182/183 each contributed over 48% of the net proceeds to the Trust.

21. In September 2008 Hurricane Ike swept through the Louisiana gulf coast area. Ike was devastating to the Royalty Properties. It completely destroyed all the wells, production platforms, sales platforms and other infrastructure on Eugene Island 339. It destroyed the infrastructure, including the pipelines that enabled sales of production from Ship Shoal 182/183.

22. Ike eliminated virtually all the Trust income, and in the immediate aftermath it was unclear if that income would ever be restored. With little to no revenue coming in, the Trustees tapped the reserve to pay administrative expenses, rapidly depleting it. In 2008 the reserve for trust expenses was \$2,233,291. By the end of 2009, the reserve had fallen by almost a million dollars to \$1,263,080. That was barely enough to provide a reserve for one year of administrative expenses. By the end of 2010 the reserve was down to \$352,017.

23. Further, although the Trust was not paying operating costs out of pocket, the operating losses were mounting, increasing the net loss carryforward that would have to be

repaid before the Trust would receive any distributions of profits. At the beginning of 2008, there was no net loss carryforward. By the end of 2011, however, it had grown to almost \$7 million. The chart below shows a change in the net loss carryforward from 2008 forward.

<b>Year</b>	<b>Net Loss Carry Forward (as of Q 1 of following year)</b>
2006	\$0
2007	\$0
2008	(\$1,174,901)
2009	(\$6,066,487)
2010	(\$3,684,455)
2011	(\$6,806,012)
2012	(\$6,940,696)
2013	(\$4,927,130)
2014	(\$2,054,155)

24. As the chart reflects, there was a temporary drop in the net loss carryforward in 2010, as it went from over \$6 million to \$3.7 million. While that might appear to have been a good thing, that temporary decrease in the net loss carryforward resulted from a short-sighted decision by Chevron to use the funds in the special cost escrow account to decrease the net loss carryforward. As noted above, the funds in the special cost escrow account were to be used for future capital expenditures such as plugging the wells. By using them to decrease the net loss carryforward Chevron was, in effect, robbing Peter to pay Paul. In the future, Chevron would have to replenish the special cost escrow account using revenues that might otherwise be distributed to the Trust.<sup>1</sup>

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<sup>1</sup> Actually, the Trustees urged Chevron to do something even more foolhardy: distribute the special cost escrow account to the Trust for it to pay its expenses. That would have further guaranteed no distributions to the Beneficiaries for the indefinite future.

25. The Trustees' SEC filings told the grim tale. In their 2008 Form 10-K (filed in March 2009), the Trustees said: "Future distributions by the Trust are expected to be severely negatively impacted, and there may not be sufficient Net Proceeds from the Royalty Properties to make one or more future distributions." In each Form 10-K since then until the filing of this suit (2009 – 2014), the Trustees said "there are not likely to be sufficient Net Proceeds from the Royalty Properties for the Trust to make a regularly scheduled quarterly distribution to Beneficiaries for the foreseeable future," or something substantially similar.

C. In December 2009, Chevron elected not to redevelop Eugene Island 339 and instead gave the rights to a third party, thereby reducing the Trust's profit interest by 65%.

26. Production from Ship Shoal 182/183 eventually resumed in October 2009. Because Hurricane Ike had completely destroyed all the wells and infrastructure on Eugene Island 339, it would have to be completely redeveloped for any production to resume. As the Trustees noted in their SEC filings, whether Chevron chose to spend the money to redevelop Eugene Island 339 was an important fact that, at the time, was unknown.

27. After evaluating the economics of redeveloping Eugene Island 339 for over a year, Chevron decided not to spend its own money to do so. Instead, it made a farmout agreement with Arena Energy. Under this agreement, Chevron gave Arena the right to drill wells and, upon drilling a producing well, Arena would earn 65% of the working interest. This 65% was not subject to the Trust's Net Profits Interest. As a result of Chevron's farmout, the Trust's share of any revenues from any new wells on Eugene Island 339 would be cut by 65%. Thus, even if Arena were able to restore Eugene Island 339 to pre-Ike production levels and revenues, the Trust would only get 35% of what it had before. Given that pre-Ike revenue from Eugene Island 339 was approximately half of the Trust's revenue, in the best of all worlds the

Trust stood to lose over 30% of its revenue (65% of 50% equals 32.5%) even if Eugene Island 339 were to return to pre-Ike levels. Arena eventually drilled four wells in 2012 and 2013, but production never came close to pre-Ike levels.

D. Faced with no net revenues and mounting costs, from 2009 until 2014 the Trustees did nothing to protect the Beneficiaries and Trust property. Instead, they borrowed money and sold interests to pay themselves—steps that benefited them but not the Beneficiaries and ensured that the Beneficiaries would never see another dime.

28. For over a year after Ike, the Trust received no income from the Royalty Properties. Eventually some revenues from Ship Shoal 182/183 resumed. Meanwhile, the administrative expenses continued and even increased.

29. By the end of 2009 things were looking dire. The administrative expenses were close to a million dollars per year, and the Trust only had reserves sufficient to pay those expenses for a little over one more year. There was a net loss carryforward of over \$6 million. By 2010 things were worse. Trust administrative expenses were still running at close to a million dollars, but the reserve to pay those expenses was down to \$352,000. And, as noted above, Chevron had completely depleted the special escrow account to lower the net loss carryforward. As of the end of 2010 there still was no production from Eugene Island 339. Below are the relevant numbers for the end of the years 2009-2010:

Year	Distributable Income	G&A Expenses	Reserve for Future Trust Expenses	Special Escrow Account	Net Loss Carry Forward (as of Q 1 of following year)
2008	\$13,298,654	\$840,455	\$2,233,291	\$4,325,503	(\$1,174,901)
2009	\$0	\$971,545	\$1,263,080	\$4,306,275	(\$6,066,487)
2010	\$0	\$911,245	\$352,017	\$1,000	(\$3,684,455)



30. In short, it was obvious by the end of 2009 that the revenues would not be sufficient to cover Trust expenses for the foreseeable future. Indeed, the Trustees said so in their SEC filings.

31. By 2009 the Trustees knew the dire situation. They considered various options to deal with the problem. These included selling part of the property, obtaining loans and even resigning as Trustees. However, they did not disclose any of these options – or that they were considering these options—to the Beneficiaries. They certainly did not tell the Beneficiaries that the situation was so bad that the Trustees were considering resigning—an act that might help the Trustees but would do the Beneficiaries no good.

32. The Trust Agreement empowered the Trustees to sell the Net Profits Interest. One of the purposes of the Trust is to protect and conserve, for the benefit of the Beneficiaries, the Trust property. The Trustees had a duty to protect the Beneficiaries' interests by selling the Net Profits Interests rather than blindly holding onto them until they had no value to the Beneficiaries. Indeed, the Corporate Trustee discussed selling all the Net Profits Interest in 2010.

33. Rather than selling the Net Profits Interest, however, in 2010 the Trustees sought directors and officers liability insurance to protect Swanson, Evans and Owen. The Trustees bought this insurance in 2011. Through 2015, the Trustees took more than \$120,000 of Trust money to pay for this insurance. The Trustees put their interests ahead of the interests of the Beneficiaries by using Trust funds for their own benefit while the Beneficiaries received zero benefit.

34. While the cash flow situation was bad, the properties still had significant value. Even though the properties were not profitable for the Trust with its huge annual administrative

expenses, they could have been sold to someone who could operate them profitably without those expenses. The Trustees could have sold all the Net Profits Interests after Hurricane Ike for \$20 million or more. Each year the petroleum engineering firm of DeGolyer and MacNaughton determined the reserves of the Royalty Properties and the Partnership's projected future net revenues as of October 31. The Trustees included the "total future net revenues" attributable to the Partnership's interest in its securities filings. As of October 31, 2010 the DeGolyer and MacNaughton report showed that the total future net revenues were close to \$20 million.

35. While the Trustees had the power to sell the Net Profits Interest without approval from the Beneficiaries, they had another option. Paragraph 6.04 of the Trust Agreement authorizes the Trustees to sell some or all of the Trust property upon the affirmative vote of a majority of the Beneficiaries. Although the Trustees considered this option as early as 2009, they never called for a vote. The Corporate Trustee explained that it did not call for a vote because it allegedly received unsolicited calls from a few Beneficiaries requesting that the Trust hold on to the properties. The Trustees never asked the Beneficiaries whether they wanted such a meeting, and they never attempted to set such a meeting.

36. The Trustees' reasons for not pursuing this option are implausible. The Trustees claim that they were concerned about the cost and difficulty of notifying all the Beneficiaries and scheduling a vote, but that cost would have been a fraction of one years' worth of administrative expenses. While the Trustees' reasons for not calling for a Beneficiary vote are implausible, their motivation for not doing so is all too obvious: the longer the Trust continued, the more they would get paid. The Trustees sought to shut down the Trust only when there was no possibility that they would get paid.

37. Instead, in 2011, needing money to pay their compensation and other expenses, the Trustees agreed to sell 20% of the Trust’s Net Profits Interest at auction. RNR Production Land and Cattle Company (“RNR”) won the auction with a bid of \$1,600,000. The sale was effective on October 27, 2011. All the net proceeds the Trust received went to pay Trust administrative expenses; none went to the Beneficiaries.

38. The 2011 sale to RNR proved that the Net Profits Interests had value. Rather than selling the remaining Net Profits Interests at that time or shortly thereafter, the Trustees did nothing. Selling 20% of the Net Profits Interest in 2011 to pay their compensation and other administrative expenses caused the Trust to descend into a death spiral. After the sale, the Trust had only 80% of its revenue stream—already reduced by the Arena farmout—but still had roughly the same amount of annual administrative expenses. This sale assured that the Trustees would have to take other extreme measures to continue to pay their compensation and other future administrative expenses and also made any future distributions to Beneficiaries less and less likely.

39. Even the short term reduction of the net loss carryforward in 2010 was gone by 2011; by then the net loss carryover was close to \$7 million. As a result of the RNR sale the reserve for trust expenses was up to \$944,000—only enough for about a year of Trust administrative expenses. And, of course, the special cost escrow account was gone.

40. By the end of 2012 the reserve for trust expenses was only around \$224,000. The net loss carryforward was approximately \$7 million, and, of course, there was no special cost escrow account. The chart below summarizes these amounts:

<b>Year</b>	<b>Distributable Income</b>	<b>G&amp;A Expenses</b>	<b>Reserve for Future Trust Expenses</b>	<b>Cost Escrow Account</b>	<b>Net Loss Carry Forward (as of Q 1 of following year)</b>
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2008	\$13,298,654	\$840,455	\$2,233,291	\$4,325,503	(\$1,174,901)
2009	\$0	\$971,545	\$1,263,080	\$4,306,275	(\$6,066,487)
2010	\$0	\$911,245	\$352,017	\$1,000	(\$3,684,455)
2011	\$0	\$894,113	\$944,917	\$1,000	(\$5,444,265)
2012	\$0	\$721,053	\$223,925	\$1,000	(\$5,552,002)

41. In response to this predicament the Trustees chose not to sell the Net Profits Interest, or to call a meeting of Beneficiaries to vote to approve the sale of a Net Profits Interest, or to go to court to ask for relief before the Trust became even more financially troubled. Instead, the Trustees first borrowed \$300,000 from BONY's affiliated bank to keep paying themselves. Then on August 1, 2013 the Trustees sold 25% of their remaining Net Profits Interest at auction to RNR. The net proceeds to the Trust from this sale were \$1,151,885. Of those, the Trust used \$300,000 to repay the loan. As a result of the second sale the Trustees had an even lower income stream with which to pay administrative expenses. Again, the Beneficiaries received nothing.

42. Then, on October 1, 2014 the Trustees borrowed \$363,000 more from BONY's affiliated bank. Finally, on September 25, 2015 the Trustees executed another promissory note with the bank, this time in the amount of \$1,056,885 (this amount included the previous \$363,000). Of course, these loans further assured there would never be any money for the Beneficiaries, only for the Trustees. Even with the loans, by the end of 2013 the reserve for Trust expenses covered only about a year's worth of Trustee fees. There was no special cost escrow account. The net loss carryforward was around \$5 million.

43. From 2009 through 2014, administrative expenses have averaged more than \$850,000 per year, including more than \$218,000 per year in Trustee compensation:

	2009	2010	2011	2012	2013	2014	Total
Total trustee compensation	\$238,849	\$299,336	\$305,687	\$129,754	\$0	\$339,414	\$1,313,040

	2009	2010	2011	2012	2013	2014	Total
Total accountant fees	\$219,050	\$212,550	\$183,000	\$158,000	\$143,000	\$147,000	\$1,282,650
Subtotal -- trustee compensation and accountant fees	\$457,899	\$511,886	\$488,687	\$287,754	\$143,000	\$486,414	\$2,595,690
Total general and administrative expenses	\$971,545	\$911,245	\$894,113	\$721,053	\$502,203	\$1,109,000	\$5,949,614
G&A expenses other than trustee compensation and accountant fees	\$513,646	\$399,359	\$405,426	\$433,299	\$359,203	\$622,586	\$3,353,924

§ -- Trustee compensation was not reported on the 2008 10-K, but it likely was paid.

The Trust continued to incur administrative expenses after 2014, which expenses are not included in the above table.

44. While the net loss carryforward has lingered and administrative expenses have continued to mount, the value of the Trust's property has declined. Below is the decline in total future net revenues:

Year	D&L Reserve Study Total Future Net Revenues as of Oct. 31	Decline in Value From This Year to 2015	Notes
2007	\$54,800,000	(\$52,617,338)	Last report prior to Hurricane Ike
2008	\$24,200,000	(\$22,017,338)	
2009	\$13,100,000	(\$10,917,338)	
2010	\$19,800,000	(\$17,617,338)	Last report before the sale of 20% of the Net Profits Interest on October 27, 2011, to pay expenses
2011	\$11,500,000	(\$9,317,338)	Reflects the reduced Net Profits Interest due to the 2011 sale

Year	D&L Reserve Study Total Future Net Revenues as of Oct. 31	Decline in Value From This Year to 2015	Notes
2012	\$14,500,000	(\$12,317,338)	Last report prior to the sale of 25% of the remaining Net Profits Interest on October 31, 2013, to pay expenses
2013	\$8,600,000	(\$6,417,338)	Reflects the reduced Net Profits Interest due to the 2011 and 2013 sales
2014	\$7,304,878	(\$5,122,216)	
2015	\$2,182,662		

45. Total future net revenues attributable to the Partnership's interest in the Royalty Properties were estimated at \$2,182,662 as of October 31, 2015, based the DeGolyer and MacNaughton reserve study. This is approximately \$17,600,000 less than total future net revenues estimated as of October 31, 2010. During this time, the Beneficiaries received no benefit from the Trust's retention of the Net Profits Interest. The only benefit went to the Trustees personally and to the Trust's lawyers, accountants and engineers.

46. Since at least late 2009, the Trustees knew that there would be insufficient revenue to make distributions to Beneficiaries for the foreseeable future. The writing was on the wall—and in big red letters. By the end of 2009 at the latest, when Chevron opted not to redevelop Eugene Island 339, it was obvious that the Royalty Properties were in dire straits and could not provide distributions to the Beneficiaries for the foreseeable future, if ever. Indeed, the Trustees repeatedly said so in their SEC filings. But at any time thereafter up to the time the Trustees filed their action to terminate the Trust in 2014, the property still had substantial market value, as evidenced by the sale to RNR in 2011 at a premium over the equivalent unit price and the sale to RNR in 2013. Had the Trustees put the Beneficiaries' interests above their own, they would have pursued a sale of all the properties in 2009 or 2010. In the alternative, they should

have pursued a sale of all the properties at some time prior to the filing of the Trust termination action in 2014. They could sell the interest without a Beneficiary vote, or they could get authority for a sale by calling a meeting of all the Beneficiaries, fully disclosing the financial situation and asking for a vote to allow the sale. If an affirmative vote could not be attained, they had a duty to seek court instructions or seek to modify the trust terms to address the situation—as they finally did in 2014. Although the Trustees knew of and even considered these options, they did none of them, in breach of their duties. Rather than looking for a way to sell all the Net Profit's Interest and shutting down the Trust—preserving value for the Beneficiaries—the Trustees did nothing except incur expenses, including paying themselves over a million dollars.

E. In 2014, when there was nothing left to pay them, the Trustees finally sought court approval to sell all of the Royalty Properties.

47. In July 2014, the Trustees filed this action to modify and terminate the Trust. The Trustees' authority to do so—Section 112.054 of the Texas Trust Code— did not change from 2009 through 2014: The Trustees were empowered to seek a court order terminating the Trust if the purposes of the Trust have become impossible to fulfill or if, because of changed circumstances since the drafting of the Trust agreement, termination will further the purposes of the Trust. The Trustees admit in the Petition that these reasons exist. These reasons have existed since at least 2009, yet the Trustees waited until 2014 to act.

48. The Trustees' delay in seeking the sale of all of the Trust's interest in the Royalty Properties and termination of the Trust estate has damaged the Trust and its Beneficiaries. This damage includes millions of dollars in unnecessary administrative expenses and a decline in value of the Trust's property in the millions of dollars.

49. The Trustees benefited personally by this delay by receiving more than \$1,000,000 in Trustee compensation during this period. The Corporate Trustee also benefited because its affiliate bank received interest for the money loaned to the Trustees.

F. The Corporate Trustee intentionally breached the trust by paying itself what it wanted to be paid rather than following the compensation requirements of the Trust Agreement.

50. The Trust Agreement required the Corporate Trustee to keep track of the hours spent by its trust officer in order to determine the Corporate Trustee's compensation. The Corporate Trustee intentionally breached the trust by not tracking the hours spent but rather by paying itself a fee of its choosing. This breach of trust occurred from 2009 through 2014, and Ad Litem believes that it may have begun before 2009. From 2009 through 2014, the Corporate Trustee paid itself approximately \$1,000,000 in breach of trust. This was not disclosed to the Beneficiaries.

G. Because of the Trustees' breach of their duty of full disclosure, the Beneficiaries did not discover and could not have discovered their claims until after discovery in this suit.

51. The Trustees unquestionably owe the Beneficiaries fiduciary duties. These duties include a duty of full disclosure of all material facts known to them that might affect the Beneficiaries' rights.

52. The only disclosures that the Trustees made to the Beneficiaries were those in SEC filings. As noted, those disclosures did state that "there are not likely to be sufficient Net Proceeds from the Royalty Properties for the Trust to make a regularly scheduled quarterly distribution to Beneficiaries for the foreseeable future." But neither in those disclosures nor in any other communication did the Trustees tell the Beneficiaries that:

- The situation was so bad by late 2009 that the Trustees were considering resigning;



- The Trustees in late 2009 were considering selling all or some of the interests;
- As of late 2009 the Trustees were considering borrowing money to pay themselves and other administrative expenses;
- The Trustees considered calling a vote and let the Beneficiaries decide whether to sell all the net profits interests, but the Trustees decided not to do so;
- Notwithstanding the destruction of Hurricane Ike, the Trustees could have sold all of the net profits interests for the benefit of the Beneficiaries rather than continuing the Trust for their own benefit.
- The Corporate Trustee intentionally breached the trust by paying itself what it wanted rather than following the terms of the Trust Agreement.
- That the conduct of the Trustees was so egregious that it probably constituted bad faith, gross negligence, reckless indifference or intentional breach of trust that would enable the Beneficiaries to recover damages for the Trustees' breaches.

53. These facts would have been important to the Beneficiaries, but they were never disclosed. As a result, it was only after discovery in this case—and in particular the July 2016 deposition of the representative of the Corporate Trustee—that Ad Litem obtained knowledge of the Trustees' breaches of fiduciary duties, their egregious nature and the damages therefrom. Accordingly, Ad Litem pleads that under the application of the discovery rule during an ongoing fiduciary relationship, the running of any statute of limitations was suspended until the end of July 2016, when the fact of misconduct became apparent. Until then, the Beneficiaries were unaware of the need to inquire into the Trustees' conduct.

#### **IV. Causes of Action**

##### A. Accounting

54. The foregoing paragraphs are fully incorporated herein.

55. The Trustees have a duty to account to the Beneficiaries of the Trust under Section 113.151 of the Texas Trust Code if demanded to do so by a beneficiary. The Trustees also have a duty of full disclosure of all material facts known to them that might affect a beneficiary's rights. *Montgomery v. Kennedy*, 669 S. W. 2d 309, 313 (Tex. 1984).

56. The Trustees have filed periodic disclosures with the Securities and Exchange Commission to comply with securities laws. These disclosures include annual Form 10-Ks filed on or about March 31 of each year.

57. The 10-K filings disclose significant “general and administrative expenses,” trustee compensation and accounting fees. The Trustees have also borrowed money from an affiliate of the Corporate Trustee to pay the Trust’s financial obligations, including general and administrative expenses.

58. The general and administrative expenses of the Trust are material facts that affect the Beneficiaries’ rights. In particular, these expenses in part have eliminated entirely the amount of distributions from the Trust to the Beneficiaries.

59. Ad Litem demands a detailed accounting of general and administrative expenses and trustee compensation for the years 2008 through the present and such other relevant information as the Court may determine within 60 days of the Court’s order.

B. Breach of Fiduciary Duty

60. The foregoing paragraphs are fully incorporated herein.

61. The Trustees owe the Beneficiaries a duty to act competently and prudently. One of the express purposes of the Trust is to protect and conserve the Trust property for the benefit of the Beneficiaries. *See* Section 2.02(a) of the Trust Agreement. The Trustees are required to take such actions as in their judgment are necessary, desirable or advisable to achieve the purposes of the Trust. *See* Section 6.01 of the Trust Instrument.

62. The Trustees are required to manage Trust assets as a prudent investor would, considering the purposes, terms, distribution requirements, and other circumstances of the Trust, and in doing so the Trustees must exercise reasonable care, skill, and caution. Tex. Trust Code

§117.004(a). In addition, the Trustees have special skills or expertise to operate the Trust and its properties, including but not limited to special skills and expertise in the oil and gas industry. As such, the Trustees are required to use those special skills and expertise. Tex. Trust Code §117.004(f).

63. By their actions and inactions described above, the Trustees have failed to act competently and prudently. These breaches of the Trustees' duty have damaged the Trust estate and caused harm to its Beneficiaries.

64. The Trustees also owe the Beneficiaries the duty of loyalty. The Trustees were required to manage the Trust assets solely in the Beneficiaries' interest. Tex. Trust Code §117.007. The Trustees benefited personally by continuing to pay themselves compensation while failing to act to protect and conserve the Trust property and the interests of the Beneficiaries. By their actions and inactions described above, the Trustees have breached their duty of loyalty. These breaches of the Trustees' duty have damaged the Trust estate and caused harm to its Beneficiaries.

65. The Trustees' actions constitute self-dealing. They profited from their decision to continue the Trust by receiving additional compensation. They profited from their decision to buy insurance to cover their actions rather than fulfilling their duties by selling the Net Profits Interest. The Corporate Trustee profited from paying itself what it wanted to receive rather than following the compensation provisions of the Trust Agreement. The Trustees must prove that their actions were fair and equitable to the Beneficiaries.

66. The Trustees owe the Beneficiaries a duty to administer the Trust in good faith and in accordance with the purposes of the Trust. Tex. Trust Code §111.0035(b)(4)(B). By their conduct described above, the Trustees breached their duty to administer the Trust in good faith

and in accordance with the purposes of the Trust. These breaches of the Trustees' duty have damaged the Trust and its Beneficiaries.

67. The Trustees' failure to call for a vote of the Beneficiaries to sell the Royalty Properties was a breach of fiduciary duty. This breach of fiduciary duty damaged the Trust estate and caused harm to its Beneficiaries.

68. The Trustees had a duty to petition the court for an order to sell the Trust's interests in the Royalty Properties and to terminate the Trust long before they filed their petition in July 2014.

69. Since 1984, Section 112.054(a) of the Texas Trust Code has permitted a trustee to petition a court for an order to deviate from the terms of a trust and/or to terminate a trust if its purposes have become impossible to fulfill. Since 2005, Section 112.054(a) of the Texas Trust Code also has permitted a trustee to petition a court for an order to deviate from the terms of a trust and/or to terminate a trust if, because of changed circumstances, the order would further the purposes of the trust, or if changing an administrative, non-dispositive provision of the trust instrument is necessary or appropriate to prevent waste or avoid impairment of the trust's administration. Tex. Trust Code §112.054(a)(2) and (3). In their 2014 petition the Trustees admit that changed circumstances exist to justify a modification or termination of the Trust. Those circumstances existed in 2009 and have not changed. An order changing the trust instrument to permit the sale of Trust's Net Profits Interest would have prevented waste and avoided the impairment of the Trust's administration through the period beginning in 2009 and ending in 2014 when the Trustees filed their action to terminate the Trust.

70. If a trustee knows or should know of: (a) circumstances that justify judicial action to modify an administrative provision of a trust and (b) the potential of those circumstances to

cause substantial harm to the trust or its beneficiaries, the trustee has a duty to petition the court for appropriate modification of or deviation from the terms of the trust. Restatement (Third) of Trusts §66(2) (2003). Here, petitioning the court for an order to sell the Trust's share of the Royalty Properties (an administrative provision) would have prevented substantial harm to the Trust and its Beneficiaries and would have triggered the termination of the Trust under Section 9.01(a) of the Trust Instrument. This action would have preserved value for the Beneficiaries and eliminated millions of dollars in operating costs and administrative expenses.

71. By their actions and inactions described above, the Trustees have breached this duty. These breaches of the Trustees' duty have damaged the Trust estate and caused harm to its Beneficiaries.

72. In addition, the Corporate Trustee has breached its fiduciary duty by paying itself compensation contrary to the terms of the Trust Agreement. Rather than following the terms governing compensation in the Trust Agreement, the Corporate Trustee paid itself what it wanted. This action shows an intentional disregard for Trustee's obligations under the Trust Agreement and is an intentional breach of trust that has damaged the Trust estate and caused harm to its Beneficiaries.

73. Because of this conduct, the Court should grant the following remedies:

a. The Court should charge the Trustees with any damages resulting from the Trustees' breaches of trust, including but not limited to any loss or depreciation in value of the trust estate as a result of the breach of trust, any profit made by the trustee through the breaches of trust, and any profit that would have accrued to the trust estate if there had been no breaches of trust. Tex. Trust Code §114.001(c).

b. The Court should deny the Trustees compensation and order them to disgorge all compensation, interest, liability insurance premiums and other benefits received by any one or more of the Trustees. Tex. Trust Code §§114.008 and 114.009.

c. The Court should order Trustees to pay personally all attorney's fees and costs, including but not limited to the Trustees' own attorneys' fees and costs as well as those of Ad Litem and any other party to this proceeding, and to reimburse the trust estate of the Trust for any attorneys' fees and costs already paid from the Trust. *See* Tex. Trust Code §114.064 and "Claim for Ad Litem's Compensation and Expenses and For Award of Attorney's Fees and Costs Against Trustees" later in this pleading.

C. Negligence

74. The foregoing paragraphs are fully incorporated herein.

75. The Trustees' actions and inactions constitute negligence that proximately and directly caused damage and injury to the Beneficiaries of the Trust who were served by publication and did not answer or appear.

76. Because of these actions and inactions, the Court should enter judgment jointly and severally against the Trustees in an amount equal to the actual damages sustained.

D. Gross Negligence, Reckless Indifference, Intentional Conduct and Bad Faith

77. The foregoing paragraphs are fully incorporated herein.

78. The Trustees' actions and inactions constitute gross negligence that proximately and directly caused damage and injury to the Trust and its Beneficiaries. In addition, the Trustees acted with reckless indifference that proximately and directly caused damage and injury to the Trust and its Beneficiaries. Finally, and in the alternative if necessary, the Trustees have acted intentionally and in bad faith.

79. Because of these actions and inactions, the Court should enter judgment jointly and severally against the Trustees in an amount equal to the actual damages sustained.

E. Fee Forfeiture and Punitive Damages

80. The foregoing paragraphs are fully incorporated herein.

81. The Trustees' actions and inactions described above constitute a clear and serious breach of their fiduciary duty. Accordingly, the Court should order them to forfeit all compensation received under the Trust Agreement and to repay that compensation to the trust estate of the Trust.

82. Pleading further and in the alternative if necessary, the Court should impose punitive damages against the Trustees.

F. Claim for Ad Litem's Compensation and Expenses and For Award of Attorney's Fees and Costs Against Trustees

83. The foregoing paragraphs are fully incorporated herein.

84. Ad Litem is entitled to reasonable compensation for services and for reimbursement of costs as are equitable and just pursuant to Sections 114.064 and 115.014(e) of the Texas Trust Code.

85. In addition, because of the actions and inactions and breaches of fiduciary duties of the Trustees described above, pursuant to Section 114.064 of the Texas Trust Code the Court should order the Trustees to pay personally all attorney's fees and costs, including but not limited to the Trustees' own attorneys' fees and costs as well as the compensation of Ad Litem and the reasonable and necessary attorney's fees and costs of Ad Litem and any other party to this proceeding. It is equitable and just to do so.

86. To the extent any of the amounts described in the preceding paragraph have already been paid from the Trust, the Trustees should be ordered to reimburse the trust estate of the Trust.

87. Alternatively, if necessary, if all of Ad Litem's compensation and expenses are not awarded against Trustees personally, Ad Litem's actions have benefited all Beneficiaries of the Trust. Under the common fund doctrine, Ad Litem's fees and expenses and those of his litigation counsel and experts should be borne by all of the Beneficiaries and not solely by the unit holders of Trust who were served by publication and did not answer or appear in this proceeding. Therefore, it would be equitable and just to pay those fees and expenses from the trust estate of the Trust.

88. Alternatively, if necessary, it would be equitable and just to pay Ad Litem's fees and expenses and those of his litigation counsel and experts from the trust estate of the Trust.

#### **PRAYER**

Ad Litem prays that the Court will:

a. Order the Trustees to provide a detailed accounting of general and administrative expenses for the years 2008 through the present and such other information deemed relevant by the Court within 60 days of the Court's order;

b. Charge the Trustees with any damages resulting from the Trustees' breaches of trust, including but not limited to any loss or depreciation in value of the trust estate as a result of the breach of trust, any profit made by the trustee through the breaches of trust, and any profit that would have accrued to the trust estate if there had been no breaches of trust;



c. Order the Trustees to pay money damages in an amount of the actual damages proximately caused by the Trustees' negligence, gross negligence, intentional conduct and bad faith;

d. Deny the Trustees' compensation and order each Trustee to disgorge all compensation, interest and other benefits received by him or it;

e. Order the Trustees to pay individually their own attorney's fees and costs and the reasonable and necessary attorney's fees and costs of each party to this proceeding and to reimburse the trust estate of the Trust for any amounts already paid from the Trust;

f. Award Ad Litem a reasonable fee for services and reimbursement of Ad Litem's costs and expenses, to be charged against the Trustees individually;

g. Award punitive damages;

h. Award pre-judgment and post-judgment interest; and

i. Award Ad Litem such other and further relief to which he may be entitled.

Respectfully submitted,

SCOTT DOUGLASS & McCONNICO LLP  
303 Colorado Street, Suite 2400  
Austin, Texas 78701  
(512) 495-6300 Telephone  
(512) 495-6399 Facsimile

By: /s/ Daniel C. Bitting

Daniel C. Bitting  
State Bar No. 02362480  
[dbitting@scottdoug.com](mailto:dbitting@scottdoug.com)  
Cynthia L. Saiter  
State Bar No. 00797367  
[csaiter@scottdoug.com](mailto:csaiter@scottdoug.com)

**Attorneys For Attorney Ad Litem**

THE KARISCH LAW FIRM, PLLC

By: /s/ Glenn M. Karisch

Glenn M. Karisch

State Bar No. 11098950

301 Congress Avenue, Suite 1910

Austin, TX 78701

(512) 328-6346 (telephone)

(512) 597-4062 (fax)

[karisch@texasprobate.com](mailto:karisch@texasprobate.com)

**Attorney Ad Litem**

**CERTIFICATE OF SERVICE**

I hereby certify that a true and correct copy of the foregoing has been served or will be served in accordance with the Court's orders regarding service dated September 28, 2015 and January 21, 2016.

/s/Glenn M. Karisch

Glenn M. Karisch