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Pre-emption of Texas Trust Law by Federal Law

Facts

An irrevocable trust was established in Texas by Texas residents. Subsequently, the trustee, which is a national banking association, merged with another national banking association. That national banking association later consolidated with another national banking association, whose stock was acquired by another national banking association through a stock purchase agreement.

Question Presented

- Will Texas law govern the succession of the trustee in terms of requiring the national banking associations to file an action in state district court in order for the merger/ consolidation/ stock purchase and the succession of the trusteeship to be effective?

Short Answer

- Federal law will pre-empt the Texas Trust Code and pursuant to 12 U.S.C. §§ 215(e) and 215a(e) the national bank will become the successor trustee of the irrevocable trust without any requirement to file suit in the state district court.

Discussion

FEDERAL LAW WILL PRE-EMPT THE TEXAS TRUST CODE AND THE CONSOLIDATED/MERGED ENTITY WILL CONTINUE AS TRUSTEE WITHOUT ANY NEED TO FILE A STATE DISTRICT COURT ACTION

Generally, "[u]nder Texas law, in the absence of an explicit grant of authority in a will or trust instrument permitting transfer or delegation, the fiduciary responsibilities of an executor or trustee are neither transferrable nor delegable." *NCNB Texas Nat'l Bank v. Cowden,* 895 F.2d 1488, 1495 (5th Cir. Tex. 1990) (internal citations omitted). Tex. Prop. Code § 113.083(a) provides:

> "On the death, resignation, incapacity, or removal of a sole or surviving trustee, a successor trustee shall be selected according to the method, if any, prescribed in the trust instrument. If for any reason a successor is not selected under the terms of the trust instrument, a court may and on petition of any interested person shall appoint a successor in whom the trust shall vest."

Further, Tex. Prop. Code § 115.001 grants state district courts with exclusive jurisdiction over the appointment of trustees. In the instant case, however, there was a merger/consolidation of national banks, one of which is a trustee. In such a situation, the consolidated/merged entity will assume all rights, liabilities and obligations of the constituent institutions. 12 U.S.C. §§ 215(e) and 215a(e).

12 U.S.C. §§ 215(e) and 215a(e) read similarly and state in relevant part as follows:

> (e) Status of consolidated association; property rights and interests vested and held as fiduciary. The corporate existence of each of the consolidating banks or banking associations participating in such consolidation shall be merged into and continued in the consolidated national banking association and such consolidated national banking association shall be deemed to be the same corporation as each bank or banking association participating in the consolidation. All rights, franchises, and interests of the individual consolidating banks . . . shall be transferred to and vested in the consolidated national banking association by virtue of such consolidation without any deed or other transfer. The consolidated national banking association, upon the consolidation and without any order or other action on the part of any court or otherwise, shall hold and enjoy all rights of property, franchises, and interests, including appointments, designations, and nominations, and all other rights and interests as trustee, executor, administrator, registrar of stocks and bonds, guardian of estates, assignee, receiver, and committee of estates of lunatics, and in every other fiduciary capacity, in the same manner and to the same extent as such rights, franchises, and interests were held or enjoyed by any one of the consolidating banks or banking associations at the time of consolidation, subject to the conditions hereinafter provided.

Pursuant to these statutes, the consolidated bank's position as a trustee will not be changed or altered and there is no requirement to seek a court order for the succession of the trusteeship to be effective.

However, because the Texas Trust Code conflicts with the federal statutes, a determination has to be made as to which law would apply in the instant case. Although no cases could be found directly on point, at least one case from the Fifth Circuit discusses the issue. See *NCNB Texas Nat'l Bank v. Cowden*, 895 F.2d 1488, 1495 (5th Cir. Tex. 1990).

In *NCNB*, forty national and state banks in Texas that were directly or indirectly owned by First Republic Bank ("FRB") were declared insolvent. *NCNB Texas Nat'l Bank*, 895 F.2d at 1490. Thereafter, the Office of the Comptroller of the Currency ("OCC") and the Texas Banking Commissioner appointed FDIC to act as receiver of each of these institutions and in this capacity FDIC entered into forty purchase and assumption agreements with JRB Bank ("JRB Bank") to act as a bridge bank. *Id*. These agreements required FDIC to transfer certain deposits, assets, liabilities, and obligations of the closed banks to JRB Bank. *Id*. JRB Bank was later acquired by and renamed NCNB Texas. *Id*. One of the FRB banks affected by the insolvency declarations was serving as trustee of over nine hundred trusts created by various trust instruments. *Id*. at 1491. One set of obligations FDIC sought to transfer to NCNB Texas through the agreements was these fiduciary appointments previously held by this FRB bank. *Id*.

The OCC approved the terms of the agreements and FDIC, acting as receiver, sought and obtained an order approving the transaction from the United States District Court for the Western District of Texas. *NCNB Texas Nat'l Bank*, 895 F.2d at 1491. That order provided in part that "the Assuming Bank be and hereby is, appointed as successor to all rights, obligations, assets,

deposits, agreements and trusts held by the Bank as trustee, or in any other fiduciary or representative capacities, as provided in the Purchase and Assumption Agreement." *Id.*

The FRB bank was serving as trustee to several trusts created by the Cowden family. *NCNB Texas Nat'l Bank*, 895 F.2d at 1492. Two of the trusts were terminated by the Cowdens before the FRB bank became insolvent. *Id.* The FRB bank never made any distribution of assets from these trusts and thereafter NCNB Texas sought to distribute the assets as successor trustee. *Id.* The Cowdens objected and challenged the validity of NCNB Texas acting as trustee. *Id.*

NCNB Texas and FDIC then brought the present action in the District Court for the Western District of Texas seeking a judgment declaring that NCNB Texas was the valid successor to the FRB banks fiduciary appointments and enjoining the Cowdens from taking any action challenging NCNB Texas' exercise of its responsibilities pursuant to those appointments. *NCNB Texas Nat'l Bank*, 895 F.2d at 1492. The complaint alleged that the transfer of the FRB bank's fiduciary appointments to NCNB Texas was authorized by federal banking laws and federal common law, which pre-empted any conflicting Texas estate and trust laws regulating the transfer of such appointments. *Id.* In their Answer, the Cowdens alleged that FDIC was not empowered to affect a transfer of the fiduciary appointments and that NCNB Texas could not convey them good and marketable title to their trust assets. *Id.*

The district court ruled in favor of NCNB Texas and FDIC declaring NCNB Texas the successor trustee to the Cowden trusts. *NCNB Texas Nat'l Bank*, 895 F.2d at 1493. The District Court based its judgment on two alternate grounds. *Id.* First, the court held that, as a matter of Texas law, when the Texas Banking Commissioner appoints FDIC to act as receiver of a failed state bank FDIC had authority to transfer the failed bank's fiduciary appointments to a successor

institution. *Id*. Second, the court held that any Texas laws limiting FDIC's authority to transfer the fiduciary obligations of an insolvent bank were pre-empted. *Id*.

On appeal, the Fifth Circuit noted that there was clearly a conflict between Texas law relating to the selection of successor fiduciaries and FDIC's actions in attempting to transfer the FRB bank's fiduciary appointments to NCNB Texas. *NCNB Texas Nat'l Bank*, 895 F.2d at 1496. The Court held, however, that an asset of a failed bank was transferable despite a state law that restricted transferability. *Id*. at 1499. In this regard, the Court determined that the trust appointments were an asset of the failed bank and therefore pursuant to the Federal Deposit Insurance Act ("FDIA"), 12 U.S.C. §§ 1811-1832, the asset was transferable notwithstanding any contrary state law. *Id*. Accordingly, because the FDIA explicitly permitted the transfer of all assets, and the state law interfered with the FDIA, federal law preempted the contrary state statute. *Id.* at 1501.

The court held: "The Supreme Court has clearly established that state law is pre-empted to the extent it conflicts with federal law. Thus, state law is pre-empted when there is outright or actual conflict between federal and state law, or when compliance with both federal and state regulations is a physical impossibility. A conflict also exists when the state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *NCNB Texas Nat'l Bank* 895 F.2d at 1494-1495.

Significantly, although 12 U.S.C. § 215 was not the issue before the court it was nevertheless raised by the defendants to "argue that, absent an explicit direction from Congress indicating an intent to permit the transfer of fiduciary appointments, [a] statute should not be construed as pre-empting state laws regulating such transfers." *NCNB Texas Nat'l Bank*, 895 F.2d at 1497. To support their argument, the Cowdens pointed to 12 U.S.C. § 215(e) which

provides that "consolidated banks are authorized to continue in the fiduciary capacities previously exercised without resort to any appointment procedures." *Id*. Based on this section, the Cowdens argued that Congress knew how to "directly" and "actually" pre-empt state law so as to allow fiduciary appointments and interests to be transferred and that absent similarly explicit language the intent to pre-empt was absent in the case of the FDIA. *Id*. The Circuit Court noted that "[i]t is true that in section 215(e) Congress did directly pre-empt any conflicting state laws regulating the appointment of successor fiduciaries." *Id*. The Court then distinguished the present case on the grounds that it was FDIC's attempt to transfer the fiduciary appointments through the agreements and not the FDIA itself that created the conflict with state law. *Id*. at 1498.

Accordingly, the *NCNB Texas Nat'l Bank* makes clear that 12 U.S.C. § 215(e) pre-empts contrary Texas laws regulating the appointment of successor fiduciaries. Cases from other Circuit and state courts offer further persuasive support. In *De Korwin v. First Nat'l Bank*, 179 F.2d 347, 353 (7th Cir. Ill. 1949), the court held: "upon consolidation of banking corporations and trust companies, the merging corporations, though they cease to exist as entities are merged into and become integral parts of the new corporation and that, though they therefore lack formal legal existence, for the purpose of performance of their trust duties and obligations, they remain alive, by permission of the legislative body, in a new corporate entity." See also, *Rogers v. First Nat'l Bank*, 297 F. Supp. 641, 645 (D.S.C. 1969) (national banking corporations merger is governed and controlled by the applicable Federal Statutes and regulations, not by State law); *New England Merchants Nat'l Bank v. Centenary Methodist Church*, 342 Mass. 360 (Mass. 1961) (a bank acting as trustee under a will did not have to seek a new appointment from the probate court after it was consolidated with another bank).

However, with regard to supervisory jurisdiction over trust estates, federal law does not pre-empt state law. See, *Texas Nat'l Bank*, 895 F.2d at 1503. There, the Circuit Court held that once an entity is in the position of a trustee, it would be treated as any other fiduciary under state law and may be subject to removal under Texas Trust Act. Courts in other states have reached similar conclusions with regard to the supervisory jurisdiction of trust estates. See, *Henley v. Birmingham Trust Nat'l Bank*, 295 Ala. 38, 46-47 (Ala. 1975) ("The Federal Act does not address . . . fiduciary duties . . . and cannot preempt that which it does not include nor purport to deal with. The state law is, and necessarily must remain, fully intact with respect to its supervisory jurisdiction of trust estates."); *Birmingham Trust Nat'l Bank v. Henley*, 371 So. 2d 883, 893 (Ala. 1979) ("[A]s we read § 215, state courts are not foreclosed to inquire into the question of breach of fiduciary duty on the part of a national bank or a state bank involved in consolidation and merger as provided for by that act.").

Conclusion

Federal law will pre-empt the Texas Trust Code regarding the succession of a trusteeship through a bank merger/consolidation and pursuant to 12 U.S.C. §§ 215(e) and 215a(e) the national bank will become the successor trustee of the irrevocable trust without any requirement to file suit in the state district court.