# Who's the Boss?

## Bifurcation of Trustees' Duties, Directed Trustees and Delegation

UMB Private Wealth Management

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**Approved for 1.5 CLE hours in Missouri**

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## About the program

Thank you for attending today's program. The materials provided in and during this program are informational only and should not be construed as providing any legal, investment or tax advice. The suggested forms provided are for the use of attorneys only. Any forms or other materials are provided to attorneys to assist you in the creation of trusts for your clients. As is the case with any form, the attorney must, of course, assume responsibility for the form's applicability, validity and the resulting tax and non-tax consequences. An important factor to be considered is the effect of state law on the proposed document. The attorney should also be alert to developments in the law subsequent to the issuance of these forms, which might have a bearing on the applicability or validity of the forms. UMB's Will & Trust Forms are available to attorneys at no charge at umb.com. For access to UMB's Forms, please contact Wilma Weddington at wilma.weddington@umb.com or at 816-860-7487.

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# I. INTRODUCTION

As the landscape of trust administration and investment management continues to change, there is an ever increasing desire of clients to bifurcate the Trustee's duties between two or more individuals or individuals and a corporate fiduciary. Clients' motivations are varied and the appropriateness or interest in doing so may also vary depending upon the situation.

In the traditional trustee/beneficiary relationship, a Trustee's powers and responsibilities were all-encompassing. Grantors would name one or more individual or corporate Trustees with the intention that the Trustee or Trustees would have complete control over all facets of the Trust administration, including distributions, investments, recordkeeping, the production of accountings and tax preparation. The Trustee was all things to all beneficiaries. However, times have changed.

Grantors in our current financial environment often have deep, long-lasting relationships with investment advisors or brokers. While they may appreciate the accounting and recordkeeping expertise that a corporate Trustee can offer, they may not feel comfortable with strangers making decisions regarding their children's or grandchildren's distributions for their health, education, support, maintenance and other needs. Similarly, while a Grantor may want his or her spouse to decide what level of lifestyle the Grantor's children and grandchildren may enjoy, as trust beneficiaries, that spouse may not have the requisite accounting and investment background to manage the trust assets responsibly. In addition, a long-term, trusted investment advisor or broker may be happy to continue to manage the investments of the trust, but may not be willing or able to fulfill any other fiduciary duties.

In recent years, the trust world has evolved to allow Grantors the ability to have it all—they can structure their trusts to allow their favorite broker or investment manager to continue to manage the investments, their best friends or family members to weigh in on distributions, and a corporate Trustee to monitor that the trust is being managed properly and the taxes and recordkeeping are being handled appropriately.[1]

Our presentation will explore some of these different approaches to bifurcation of trustee duties and responsibilities and will highlight several guidelines and some potential pitfalls of each.

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[1] "The emergence of third party decision makers in trust administration is one of the most significant recent developments in American trust law." Kathleen R. Sherby, *"It's A Whole New Ballgame" Trust Directors, With Powers of Direction! But What About Trust Protectors?* at 1, Kansas City Estate Planning Symposium April 28, 2017. The drafters of the Uniform Trust Code state in their Comment to § 808 that trust "[a]dvisers' have long been used for certain trustee functions, such as the power to direct investments or manage a closely held business. 'Trust protector,' a term largely associated with offshore trust practice, is more recent and usually connotes the grant of greater powers, sometimes including the power to amend or terminate the trust." The UTC drafters also state in such Comment that "[s]ubsections (b)–(d) ratify the use of trust protectors and advisors." *See* https://www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=e9c00113-601a-cd94-3aec-97c75a9f6d5a&forceDialog=0.

## II. TRUSTEES IN GENERAL

### A. What is a Trustee?

A Trustee, in the simplest terms, is an individual or an entity which holds title to property for someone's benefit.[2] The Trustee may be one or more individuals, a corporate trustee, or a combination of individuals and a corporate trustee. The Trustee serves as a fiduciary.[3] One of the definitive treatises on trust law, *Scott and Ascher on Trusts*, states:

> "A Trustee is in a fiduciary relationship with the trust beneficiaries and must, therefore, administer the trust in the beneficiaries' best interest. It has often been said that the trustee is under a duty to administer the trust "solely" in the interest of the beneficiaries."[4]

### B. The Job Description

Trustees have wide-ranging roles and responsibilities in the administration of trusts. Grantors should consider whether the individuals or corporate Trustee under consideration would be able to handle the following (and this list is not exhaustive):

1. Interpret trust documents and administer trusts pursuant to the terms of the documents;
2. Manage and invest assets, including unique assets, such as real estate or closely-held business interests or valuable items of tangible personal property such as art, jewelry, coins, etc.;
3. Make adjustments to the investment portfolio based on the macroeconomic environment and Grantor-specific preferences acting as a prudent investor and balancing the needs of income beneficiaries and remaindermen;
4. Regular review of account transactions and available cash and account values, which includes monitoring of the trust's cash flow needs;
5. Collect and distribute income as appropriate;
6. Evaluate the needs of beneficiaries and distribution requests;
7. Distribute assets and establish subtrusts as needed;
8. Pay bills and claims as appropriate;
9. Custody assets;
10. Value assets, including hard to value assets like closely held business interests, real estate and other unique assets;
11. Obtain adequate insurance as necessary and pay insurance premiums, as appropriate;
12. Detailed record-keeping, accountings and preparation of year-end tax information, including preparation of trust tax returns and distribution of K-1's or Grantor Tax Letters;
13. Address estate, gift and generation skipping transfer tax issues impacting the trust;
14. Engage in regular analysis of capital gains incurred and necessary estimated tax payments;
15. Ability to allocate income and expense items between principal and income and to properly account for such;

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[2] Charles E. Rounds, Jr., Loring A Trustee's Handbook at 1 (2006).
[3] Restatement (Third) of Trusts § 78, cmt. a.
[4] Austin W. Scott, William F. Fratcher and Mark L. Ascher, Scott and Ascher on Trusts § 17.2 (5th Edition 2006) (citing Restatement (Third) of Trusts § 78 cmt. a (Tentative Draft no. 4, 2005)).

16. Analyze legal issues impacting trust administration including applicable law and choice of law issues;
17. Retain competent outside professionals as needed, such as qualified appraisers, real estate brokers, estate sales firms, accountants, legal counsel, etc.;
18. Provide required notices and information to beneficiaries;
19. Monitor the acts of others to prevent breach of trust;
20. Ability and willingness to empathize with and counsel beneficiaries where needed; and
21. Ability to say "no."

Because the job description of a Trustee is lengthy and varied, Grantors who wish to appoint individual Trustees should be sure to select individuals who are qualified to do the job. Ideally, a prospective individual trustee would have experience with investments, trust accounting principles and tax laws, an empathetic but firm personality, and attention to detail.

## C. Trustee Duties, Responsibilities and Powers

The duties, responsibilities and powers of a Trustee are all inter-related and material in determining what actions a Trustee or Trustees should be taking and what liability may arise from a failure to take those actions. While the Trustee's responsibilities and powers are often set forth in the governing instrument or by applicable state law, the core duties of a Trustee are not usually expressly addressed in the document, but are concepts which have developed through hundreds of years of trust law.[5]

All Trustees are subject to common law fiduciary duties, as well as fiduciary duties imposed by jurisdiction specific codes, statutes and regulations (referred to as the "applicable governing law").[6] While the scope of a Trustee's fiduciary duties may be defined by the provisions of the governing instrument, those duties are further subject to the applicable governing law.[7] A significant part of applicable governing law in many states is the Uniform Trust Code ("UTC"), which provides a comprehensive framework for the states which have adopted it regarding trust administration questions. As of the date of this writing, the UTC has been enacted in 32 states and the District of Columbia,[8] including Arizona[9], Kansas[10], Minnesota[11], Missouri[12] and

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[5] While trusts can be created through use of Wills, *Inter Vivos* Trusts, or Testamentary Trusts, for the sake of simplicity, we will sometimes refer to the governing instrument in this outline as the "trust agreement."
[6] Mark S. Poker, and Amy S. Kiiskila, *Prevention and Resolution of Trust and Estate Controversies*, 33 ACTEC Journal J. 262, Spring, 2008.
[7] *Id.*
[8] Alabama, Arizona, Arkansas, Colorado, District of Columbia, Florida, Kansas, Kentucky, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, New Hampshire, New Jersey, New Mexico, North Carolina, North Dakota, Ohio, Oregon, Pennsylvania, South Carolina, Tennessee, Utah, Vermont, Virginia, West Virginia, Wisconsin, and Wyoming. The Uniform Trust Code was introduced in Illinois in 2019. *See* Why Your State Should Adopt The Uniform Trust Code at https://www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=b6a369da-a914-4b64-9651-2667e102b88f&forceDialog=0. The UTC and its comments may be found at https://www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=e9c00113-601a-cd94-3aec-97c75a9f6d5a&forceDialog=0.
[9] A.R.S. 14, Ch. 11.
[10] KSA Ch. 58a.
[11] MSA Ch. 501C.

Nebraska[13].

### 1. Fiduciary Duties

While the details of a fiduciary's duties are defined by state law and vary depending on the applicable governing law and the terms of the governing law, there are certain principles of fiduciary responsibility that are generally applicable to all trustees. The following are some examples of these key fiduciary duties:

#### a) Duty of Loyalty

The trustee must administer the trust solely in the interests of the beneficiaries and the trustee must place the beneficiaries' interests above his own. *See* UTC § 802. This duty is often considered to be the most fundamental rule of trust law.[14]

#### b) Duty to Administer the Trust

The trustee has the duty to administer the trust diligently and in good faith, in accordance with the terms of the trust and applicable law.[15] In fulfilling this duty, the trustee should exercise reasonable care and skill, taking into account the particular facts and circumstances, in accordance with the provisions of the trust document, the purposes of the trust, the interests of the trust beneficiaries and the governing law.[16]

#### c) Duty of Impartiality

The trustee must balance the interests of the beneficiaries and must address conflicts among beneficiaries fairly. The trustee must give due regard to the respective interests of trust income beneficiaries and trust remaindermen.[17]

#### d) Duty to Invest Prudently

Forty-three (43) states and the District of Columbia have adopted the Uniform Law Commission's Uniform Prudent Investor Act ("UPIA").[18] The UPIA (completed in

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[12] RSMo Ch. 456.

[13] Neb. Rev. St. § 30-3801 *et seq.*

[14] Scott, Fratcher, and Ascher, Scott and Ascher on Trusts § 170; Restatement (Third) of Trusts § 78. *See also* Uniform Prudent Investor Act § 5; UTC § 802; ARS § 14-10802; CRS § 15-5-802 (2019); KSA § 58a-802; RSMo § 456.8-802; MSA § 501C.0802; Neb. Rev. St. § 30-3867; SDCL § 55-2-2.

[15] Restatement (Third) of Trusts § 76.

[16] Restatement (Third) of Trusts § 76. *See also* UTC § 801; ARS § 14-10801; KSA § 58a-801; MSA § 501C.0801; RSMo § 456.8-801; Neb. Rev. St. § 30-3866; Tex. Prop. Code § 113.051.

[17] Restatement (Third) of Trusts § 79. *See also* UTC § 803; ARS § 14-10803; CRS § 15-5-803 (2019); KSA § 58a-803; MSA § 501C.0803; RSMo § 456.8-803; Neb. Rev. St. § 30-3868.

[18] As of the date of this outline, the UPIA has been adopted in Alabama, Alaska, Arizona, Arkansas, California, Colorado, Connecticut, District of Columbia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, U.S. Virgin Islands, Utah, Vermont, Virginia, Washington, West Virginia, Wisconsin, Wyoming. The UPIA may be found at https://www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=22cb68ce-097b-178f-899d-320e70be214d&forceDialog=0.

1994) signaled a change in thought regarding the proper investment of trust assets. The UPIA provides at Section 2(a) that "[a] trustee shall invest and manage trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements, and other circumstances of the trust. In satisfying this standard the trustee shall exercise reasonable care, skill and caution."[19] Similar to the duty of impartiality, this duty requires the trustee to balance the rights of the current beneficiaries to income with the remainder beneficiaries' interest in growth.[20]

**e) Duty to Account**

The Trustee has the duty to account to the trust beneficiaries by providing periodic accountings of trust assets, liabilities, receipts, and disbursements. The trustee satisfies this obligation by providing account statements to those beneficiaries who are entitled to receive accountings in accordance with the terms of the trust agreement and applicable governing law.[21]

**f) Duty to Inform**

The Trustee must keep trust beneficiaries reasonably informed about the administration of the trust and of the material facts necessary for them to protect their interests.[22] In addition to information about the trust's assets, the Trustee should provide any additional information reasonably requested by the beneficiaries.[23]

In addition to these common law duties, there will usually be other specific obligations and tasks required of the trustee, as set out in the governing instrument. The grantor can expressly relax or restrict the duties and obligations expected of the trustee within the confines of applicable law.[24]

**2. Trustee's Powers Under the Terms of the Governing Instrument**

Working inside the framework of these basic fiduciary duties, a Grantor can then address the specific responsibilities and powers a Trustee should have within the governing instrument. It is critical for the drafting attorney to be as clear as possible in drafting the trust agreement

[19] UPIA § 2(a).
[20] Restatement (Third) of Trusts § 77. *See also* UTC § 804; ARS § 14-10804; CRS § 15-5-804; 760 ILCS 5/5; KSA § 58a-804; MSA § 501C.0804; RSMo § 456.8-804; Neb. Rev. St. § 30-3869.
[21] Restatement (Third) of Trusts § 83. *See also* UTC § 813; ARS § 14-10813; ICA § 633A.4213; KSA § 58a-813; MSA § 501C.0813; RSMo § 456.8-813; Neb. Rev. St. § 30-3878; SDCL §§ 55-2-13, 15-2-14, Tex. Prop. Code § 113.151.
[22] Restatement (Third) of Trusts § 82. *See also* UTC § 813; ARS § 14-10813; KSA § 58a-813; MSA § 501C.0813; RSMo § 456.8-813; Neb. Rev. St. § 30-3878.
[23] Poker and Kiiskila, *Prevention and Resolution of Trust and Estate Controversies*, 33 ACTEC J. 262, at 9, citing Restatement (Second) of Trusts, § 173, cmt. d.; Restatement (Third) of Trusts § 82. *See also* UTC § 813; ARS § 14-10813; KSA § 58a-813; MSA § 501C.0813; RSMo § 456.8-813; Neb. Rev. St. § 30-3878. In the states which have adopted the UTC, those provisions may vary.
[24] The UTC sets forth certain provisions which cannot be drafted around. *See* UTC § 105. *See also*, *e.g.,* 760 ILCS 5/3, ICA § 633A.1105; Tex. Prop. Code § 111.0035.

as to the powers, duties and liabilities of the Trustees.[25] The more specific a Grantor is in setting forth the Trustee's duties and responsibilities, the less risk of confusion and discord over the life of a trust.

Some of the powers and responsibilities commonly given to a Trustee in the governing instrument include the following:

a) Investment responsibility
b) Power to terminate trust due to small size
c) Power to merge trust with another trust with identical terms
d) Power to divide the trust into GST exempt and GST non-exempt shares
e) Power to hire agents
f) Power to pay expenses and taxes
g) Power to hold real estate
h) Power to deal with partnerships or other closely held interests
i) Power to charge fees[26]

### 3. Trustee's Powers Under the Uniform Trust Code

If the governing instrument is silent regarding the powers and responsibilities of the Trustee, we then look to state law to determine what powers a Trustee possesses. For states which have adopted the UTC, we look to § 815 which gives the Trustee broad powers to act on behalf of a trust:[27]

(a) A Trustee, without authorization by the court, may exercise;

(1) the powers conferred by the terms of the trust, and
(2) except as limited by the terms of the trust;

(A) all powers over the trust property which an unmarried competent owner has over individually owned property; and
(B) any other powers appropriate to achieve the proper investment, management, and distribution of the trust property.[28]

Section 816 of the UTC grants additional specific powers, including, but not limited to:

a) the power to collect, exchange, partition or sell trust property;
b) the power to borrow, pledge assets, or loan money;
c) the power to manage a business entity;
d) the power to vote stock;
e) the power to make repairs to real property;
f) the power to enter into leases;
g) the power to pay, settle or contest claims;
h) the power to pay taxes;

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[25] Shyla R. Bucker and Michelle Rosenblatt, *A Rose By Any Other Name: Utilizing and Drafting Powers for Trustees, Trustee Advisors, and Trust Protectors,* Estate Planning & Community Property Law Journal, Fall 2015.
[26] *See* UMB Will & Trust Forms at umb.com for sample forms which contain comprehensive lists of trustee's powers. For access to the UMB Will & Trust Forms see "About the Program" above.
[27] See footnote 8 for a list of states which have enacted the UTC.
[28] UTC § 815; ARS § 14-10815; KSA § 58a-815; MSA § 501C.0815; RSMo § 456.8-815; Neb. Rev. St. § 30-3880.

i) the power to pay compensation to trustees and employees of the trust;
j) the power to sign contracts; and
k) the power to invest and reinvest trust assets.[29]

#### 4. Trustee Powers in Non-UTC States

While the UTC has been widely adopted across the United States, 18 states have not adopted it as of the date of this outline. Of the states within UMB's footprint, Illinois, Iowa, South Dakota and Texas have not adopted the UTC. Fortunately, each of those states has adopted statutes governing the administration of trusts.[30] The powers set forth in these states' statutes are generally consistent with the provisions of the UTC, which is not surprising, as the drafters of the UTC and other states' drafting committees referred to and used some of these statutes as examples and guides.[31]

For further information regarding trust administration in states which have not adopted the UTC, drafters can consult the Restatement of Trusts.[32] The Restatement of Trusts, currently in its Third Edition, was published by the American Law Institute and is a compilation of the common law in effect, state case law, and relevant analysis by experts in the field. It not only summarizes existing law but plays a role in shaping the future of trust law. This resource can be very helpful for attorneys working in those states which have not adopted the UTC.

#### 5. Drafting for Applicable Law

Drafters of trust documents can approach Trustee's powers in a couple of different ways. The most common approach is to specifically list out each power which the Trustee is given in the body of the trust document. The benefit of this approach is that it eliminates some uncertainty and is an easy reference for Trustees while they are making administrative decisions. However, this approach necessitates adding several pages of material to the trust document, sometimes to the client's dismay.[33] In some cases, a client may prefer a more streamlined trust document, and the drafter may simply refer to the applicable state statutes granting trustee powers, incorporating those statutes by reference into the trust document. The downside to this approach is that it may create uncertainty or ambiguity for the Trustee in some cases.

### D. <u>Discretion v. Direction</u>

Scriveners should be careful when drafting trust documents regarding the use of the imperative versus the permissive. If a document states that the Trustee "shall" take an action, the Trustee

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[29] UTC § 816; ARS § 14-10816; KSA § 58a-816; MSA § 501C.0816; RSMo § 456.8-816; Neb. Rev. St. § 30-3881.
[30] Illinois Trusts and Trustees Act, 760 ILCS 5/1 *et seq.*; Iowa Trust Code, ICA § 633A.1101 *et seq.*; South Dakota Fiduciaries and Trusts: SDCL Title 55; Texas Trust Code, Tex. Prop. Code Title 9, Subtitle B.
[31] The Prefatory Note to the UTC states that the Texas statute, among others, was specifically referred to by the drafting committee in the drafting process. The Prefatory Note went on to add that the Uniform Trust Code was drafted in close coordination with the writing of the Restatement (Third) of Trusts (at page 4 of the UTC Prefatory Note). *See* https://www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=e9c00113-601a-cd94-3aec-97c75a9f6d5a&forceDialog=0.
[32] Restatement (Third) of Trusts 6 (2007).
[33] *See* UMB Will & Trust Forms at umb.com. An example of this approach can be found in UMB-2, Article Three.

may think he, she or it is directed with regard to that specific action and has no discretion. A trust agreement which provides that a trustee shall retain a particular asset could be interpreted quite differently from one which provides that a trustee may retain that same asset—the Trustee may feel more protected with "shall" and act with that in mind—in this way, the investment performance, growth, and resulting income of the trust could all be drastically different due to word choice.

# III. CHOICE OF TRUSTEE

The choice of Trustee for any trust will impact the trust's administration and how flexible that administration may be. However, any Trustee selected will be bound by the standard of care applicable to fiduciaries and be responsible for all of the duties and powers entrusted to the fiduciaries under the governing instrument and applicable state law.

## A. Revocable Trusts

Typically, but not always, the Grantor chooses to be Trustee of his or her Revocable Trust, until he or she is no longer able to serve due to disability or death, or until the Grantor's resignation as Trustee. A successor Trustee becomes necessary at that point. A flexible estate plan will provide for smooth transition from the Grantor as Trustee to his or her successor, especially in the event of the Grantor's disability or incapacity.[34]

## B. Irrevocable Trusts

A Trustee, other than the Grantor, generally must be chosen by the Grantor when creating an Irrevocable Trust. The Grantor may either select an individual Trustee or Trustees or a corporate Trustee or a combination of both as initial Trustee or Successor Trustee. There are advantages and disadvantages to both. With longer term trusts, it may be difficult to always identify a string of individual successors, thus a corporate trustee may be favored in such circumstances, or it may be helpful to name a corporate trustee to serve at some point as a back-up trustee.

## C. Tax Considerations

The choice of Trustee of an *inter vivos* Irrevocable Trust also must factor in tax considerations for the Grantor and individuals who are trustees and beneficiaries. Generally, the Grantor should not serve as Trustee and an "independent" Trustee is required in other cases, at least where discretion as to distributions is desired beyond ascertainable standards or the trust could possibly own life insurance on the individual Trustee's life. A beneficiary who is serving as trustee likely would be found to have a general power of appointment over a trust where he or she has a power to make discretionary distributions to himself or herself or distributions to another beneficiary for whom he or she has a legal obligation of support, if those distributions are not limited to an ascertainable standard.[35] Furthermore, even if a trust is drafted to give the beneficiary/Trustee an ascertainable standard as to distributions, any additional provision giving that trustee uncontrolled discretion can nullify the safety of the ascertainable standards.[36] Finally, if an irrevocable life insurance trust could possibly own life insurance on the life of a trustee, the assets of the trust could be

[34] *See, e.g.,* UMB-2, Article Thirteen Paragraph F for a suggested definition of "incapacitated" and methods to determine such.
[35] IRC § 2041 (b)(1)(A), IRC § 2514 (c)(1).
[36] 26 CFR § 25.2511-1(g)(2); 26 CFR § 1.674(b)-1(b)(5)(i).

found to be includible in that Trustee's estate.[37] Trust documents often contain savings provisions as to the "sensitive" trustee in an attempt to prevent unintended consequences for the individual trustee.[38] State law may also provide savings provisions in this regard.[39]

## D. Individual Trustee vs. Corporate Trustee

### 1. Factors In Favor of Corporate Trustee

a. Corporate Trustees are neutral, have expertise in administration and investment management, provide stability and continuity over the often long term duration of a trust and are regulated internally and externally, providing more assurances of proper trust management.

b. Individual Trustees often lack expertise and systems which corporate trustees possess to effectively manage a Trust and to adequately carry out their fiduciary duties to the beneficiaries. Thus, many individual Trustees will need to hire experts in the areas of investments, taxation, accounting, etc., in order to adequately carry out their responsibilities, all at a cost to the trust. Such resources are typically in house for a corporate fiduciary.

c. Age, maturity, geographic location in relation to the beneficiaries and physical health are also concerns with Individual Trustees.

d. Individual Trustees may not wish to be placed in the position of potential conflicts with other beneficiaries who are the individual's family members. Again, the neutrality of the corporate fiduciary can help neutralize difficult family dynamics.

e. Individual Trustees may not have the time needed to adequately administer the trust; Corporate Trustees have professional staffs to handle trust administration.

f. There are long term succession issues with individual Trustees due to the possibility of the individual's death or disability prior to the termination of the trust which do not exist for the corporate trustee. However, sometimes mergers or acquisitions may result in a bank or trust company the grantor did not select. Such concerns might be addressed by granting a removal power to the beneficiaries[40] or perhaps others.

### 2. Factors In Favor of Individual Trustee

a. Individual Trustees may have insight into the background of beneficiaries and the family dynamics, in general.

b. Individual Trustees may have more insight concerning the Grantor's intentions.

c. Individual Trustees may not expect compensation, or may charge less than a Corporate Trustee. A corporate Trustee will typically expect compensation in accordance with its

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[37] IRC § 2042; 26 CFR § 20.2042-1(c)(2).

[38] *See, e.g.,* UMB A-3, Paragraph E found at umb.com and discussion *infra*.

[39] *See, e.g.,* UTC § 814—Discretionary Powers; Tax Savings and the various versions of such section in states which have adopted the UTC.

[40] *See, e.g.,* UMB 2 Article Eleven, Paragraph B, found at umb.com.

published fee schedule, which may make the use of a professional Trustee cost prohibitive for smaller trusts.

d. Individual Trustees may be more flexible than a Corporate Trustee, although all of the same fiduciary duties of a trustee apply as well with the same risks and liabilities, and Individual Trustees might be more prone to claims of breach of fiduciary duty, due to inattention, inexperience or perhaps deliberate disregard for their fiduciary duties.

### 3. What About Both?

In some circumstances, the best solution is to use a combination of a family member or other trusted Individual Trustee who can provide insight into beneficiaries' needs as to distributions and a Corporate Trustee who can provide the administrative expertise for effective and proper trust management. Thus the pros and cons of individuals versus professional Trustees can be balanced. Again, careful drafting to address succession for both, along with compensation, decision-making and other issues is essential.

## IV. BIFURCATION OF TRUSTEE DUTIES AND RESPONSIBILITIES

There are a number of approaches which allow Grantors to divide the Trustees' traditional responsibilities among two or more parties. These approaches range from the simple, such as naming Co-Trustees who have different strengths and skills, to appointing a trust protector or trust advisor, to even more complex arrangements, such as providing for delegation or direction[41] in the governing instrument.

While the use of trusts with bifurcated duties has come a long way, the law hasn't completely kept up with this planning technique.[42] These flexible, bifurcated Trustee relationships, while popular with many Grantors, can also be landmines of liability for the Trustees. While Grantors may believe that they can or desire to have the best of both worlds, Trustees may have a tough time determining who bears responsibility for what, who is relieved from responsibility for which duties, and how to protect themselves from liability for their counterparts' decisions.[43] Well drafted instruments taking into account state law are essential.

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[41] Indeed, the Directed Trust Act Committee, which drafted the Uniform Directed Trust Act, recently approved by the National Conference of Commissioners on Uniform State Laws ("NCCUSL"), stated in its Prefatory Note to the Uniform Directed Trust Act: "The Uniform Directed Trust Act addresses an increasingly common arrangement in contemporary estate planning and asset management known as a directed trust. A directed trust is typically created by naming a person that is not a trustee to hold a power over the trust, such as a power over the investment, distribution, or administration functions that would otherwise have belonged to the trustee." *See* https://www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=b468d31b-3bca-8344-ca7f-ebc2e2d8d9a2&forceDialog=0. The Uniform Directed Trust Act is discussed below in Section VIII.E.7.

[42] The Uniform Directed Trust Act is an attempt to bring uniformity to the area of directed trusts, although it remains to be seen how many jurisdictions will actually adopt the Uniform Act.

[43] NCCUSL's Directed Trust Act Committee debated the issue of eliminating the fiduciary duty of a directed trustee at least to the extent the governing instrument appointed a trust director to hold one or more powers of the trustee. As discussed infra, this Committee determined to preserve "in the directed trustee a duty to avoid 'willful misconduct'". *See* Prefatory Note at

In addition to a Grantor's general desire to have a more flexible estate plan to preserve long standing relationships discussed above, the bifurcation of trustee powers and responsibilities has grown dramatically in recent years for some of the following reasons:

- increasing asset protection planning which can only be achieved if the trust is irrevocable,
- increasing use of irrevocable trusts in estate planning,
- the increasing complexity of trust assets and the use of irrevocable trusts to segregate and protect those assets, and
- the abolition of the Rule Against Perpetuities in many states which means the trust can continue in perpetuity and the need for a flexible estate plan that allows for changing circumstances.[44]

## A. Bifurcation Methods Generally

There are a number of approaches which allow Grantors to divide the traditional duties and responsibilities of the Trustee among two or more parties. These approaches include the following:

### 1. Co-Trustee

The Grantor designates in the governing instrument more than one individual and/or corporate institution to serve as Co-Trustees of the Trust.

### 2. Trust Protector

The Grantor designates in the governing instrument an individual or corporate institution as trust protector to perform certain tasks traditionally performed by a Trustee or might serve as a "watchdog" over the Trustee with the power of removal, etc. Trust protectors may also be called trust advisors, special trustees, etc.

### 3. Delegation

The Trustee may delegate certain duties and powers to a co-trustee, beneficiary or to a third party, either pursuant to powers granted in the governing instrument or under applicable state law.

### 4. Directed Trust

The Grantor formally assigns certain duties typically associated with the Trustee to a third party in accordance with the requirements of applicable state law and relieves the Trustee from liability for the actions of the third party.

## B. What's In a Name?

One of the challenges presented by the increasing use of bifurcated trustee arrangements is the inconsistent use of terminology. There is no consistent vocabulary or definitions used to describe these non-trustee powerholders. There are several terms being used by estate planners to identify

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https://www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=b468d31b-3bca-8344-ca7f-ebc2e2d8d9a2&forceDialog=0.

[44] Stuart J. Kohn and Robert A. Romanoff, *Trust Protectors in Depth*, ALI CLE Estate Planning Course Materials Journal Vol. 21, No. 3 June 2015.

these powerholders, including "trust protector," "trust advisor," "trust director," "investment advisor," "trust committee," etc.[45] As such, to fully understand the role and authority of the non-trustee powerholder, we must not pay too much attention to the title used and instead examine the powers and authority granted to that non-trustee powerholder and the applicable governing law.

### C. What Duties, Powers and Responsibilities to Divide?

The challenge when bifurcating trustee duties is determining how to divide the powers between more than one Trustee, trust protector, trust advisor, etc. Some examples of the duties and responsibilities that are commonly allocated to a co-trustee, advisor or protector include:

1. Investment decisions generally,
2. Investment decisions regarding particular assets,
3. Distribution decisions,
4. Removal and replacement of trustee,
5. Discretion to notify beneficiaries of the existence or terms of a "silent" trust,
6. Amendment of governing instrument,
7. Evaluation and/or monitoring of drug and alcohol use by beneficiaries,
8. Exercise of voting power over certain stock,
9. Valuations for hard-to-value assets, or
10. Change of situs and/or governing law.

The more specific a Grantor is in setting forth the Trustee's duties, responsibilities and powers as well as those of the trust advisor or trust protector (or whatever other language might be used for the third party director), the more informed the beneficiaries can be about what the possibilities are for the management of the trust, and the less risk the Trust and Trustees may be subject to. When the trust is well drafted, the Trustee might then be more willing to accept such an arrangement.

## V. APPOINTMENT OF CO-TRUSTEES

The most common method of bifurcating the Trustee's duties is not a new one. Grantors have been bifurcating Trustees' duties as long as trusts have been in existence simply by naming two or more Co-Trustees who are to serve jointly. Some examples of when this method might be employed include the following:

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[45] NCCUSL's Directed Trust Committee in its Prefatory Note to the Uniform Directed Trust Act states that "[t]here is no consistent vocabulary to describe the nontrustee powerholder in a directed trust." *See* Prefatory Note at https://www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=b468d31b-3bca-8344-ca7f-ebc2e2d8d9a2&forceDialog=0and *infra*. *See also* Sherby, "*It's A Whole New Ballgame" Trust Directors With Powers of Direction! But What About Trust Protectors?* at 1.

Missouri has added a definition of "trust protector" in the Missouri Uniform Trust Code's definitions (RSMo § 456.1-103) as "any person, group of persons or entity not serving as a trustee and not the settlor or a beneficiary, designated in a trust instrument to instruct or direct the trustee or charged in the trust instrument with any responsibilities regarding the trust or expressly granted in the trust instrument one or more powers over the trust. The term 'trust protector' includes but is not limited to persons or entities identified in the trust instrument as trust advisors, trust directors, distribution advisors or investment advisors." *See* Missouri H.B. 1250 (2018).

- Grantors may want to pair the knowledge and professional management brought by corporate Trustees with a friend or family member who would be more informed and connected to the personal lives of the beneficiaries.[46]
- Similarly, if a Grantor owned a specialized asset, such as closely held stock or real estate, he or she may also want to name an individual who is already involved with the management of that asset as Co-Trustee to ensure a smooth transition upon the Grantor's death or incapacity.
- In many cases, Corporate Trustees may prefer, or in some cases may require, that an individual Co-Trustee be named and given the responsibility to vote, buy and sell stock in the Corporate Trustee, in order to avoid a conflict of interest, or prefer not to have investment responsibility, and the liability accompanying it, over a large concentrated position in one asset.

As with any bifurcated trust arrangement, it is essential that the relationship between the Co-Trustees be clearly set out in the governing instrument. If not, the default state law in effect will control, which may not be what the Grantor wants. The appointment of Co-Trustees is not a panacea. As the Uniform Law Commissioners state: "Cotrusteeship should not be called for without careful reflection. Division of responsibility among cotrustees is often confused, the accountability of any individual trustee is uncertain, obtaining consent of all trustees can be burdensome, and unless an odd number of trustees is named deadlocks requiring court resolution can occur."[47] In analyzing Co-Trustee issues, we must start with an examination of both the applicable law and the governing instrument.

### A. Co-Trustees Under the Uniform Trust Code

If the governing instrument is silent, UTC § 703 provides some default rules governing the cooperation and sharing of responsibility between Co-Trustees. Not unsurprisingly, the various states' versions of the UTC, as enacted, do not have a lot of variance and largely follow the original Act.[48] The following rules are helpful in providing guidance to Trustees as to decision making:

1. If Co-Trustees are unable to reach a unanimous decision, they may act by majority decision.[49]
2. If a trustee is unavailable to act when necessary, to avoid injury to the trust, the remaining trustees or a majority of the remaining trustees can act. If a vacancy occurs in a co-trusteeship, the remaining Co-Trustees may act.[50]
3. While generally delegation of duties between Co-Trustees is allowed,[51] a trustee cannot delegate a function the grantor reasonably expected to be handled jointly by all of the Trustees.[52]

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[46] *See* Comment to UTC § 703: "Cotrustees are often appointed to gain the advantage of differing skills, perhaps a financial institution for its permanence and professional skills, and a family member to maintain a personal connection with the beneficiaries. On other occasions, cotrustees are appointed to make certain that all family lines are represented in the trust's management."

[47] Comment to UTC § 703.

[48] Please refer to the chart attached as **Appendix 1** for a comparison of the state law in Arizona, Colorado, Kansas, Minnesota, Missouri and Nebraska.

[49] UTC § 703(a); ARS § 14-10703A; MSA § 501C.0703; KSA § 58a-703(a); RSMo § 456.7-703.1; Neb. Rev. St. § 30-3859(a); CRS § 15-5-703(1).

[50] *See also* UTC § 704(b).

The UTC also addresses trustee liability in cases where not all of the Trustees agree. Section 703(h) provides that a trustee who does not join in an action or joins in executing the majority's decision and documents the trustee's dissent is not liable for such action, unless the action is a serious breach of trust. The UTC is clear that a trustee is required to exercise reasonable care to prevent a Co-Trustee from committing a serious breach of trust. The Co-Trustee also has a duty to compel a counterpart Co-Trustee to redress a breach of trust.[53]

### B. Co-Trustees in Non-UTC States

In non-UTC states, without a model act to follow, the statutes vary.[54] Texas, South Dakota, Iowa and Illinois all follow the "majority rules" approach. While the Texas, South Dakota and Illinois statutes closely track the language of UTC § 703, Iowa's language is a little different, and makes it clear that all Co-Trustees, whether or not they are in the majority or are participating in a decision, still have a duty to act as Trustee and participate in the administration of the trust.[55]

### C. Drafting for Co-Trustees

In order to avoid uncertainty and to attempt to minimize risk for the Trustees, the relationship between the Co-Trustees should be well-defined in the governing instrument. Drafters need to clearly specify the rules of engagement between Co-Trustees, and the following questions are a good place to start:

- Who should have custody of the trust assets?
- Are the co-trustees to make decisions unanimously? Will a third party be designated to be a tie-breaker in case of deadlock? Or, will one of the trustees be able to veto the other(s)?
- If there are only two co-trustees, how do you resolve a split decision?
- If there are more than three trustees, can a majority of the co-trustees bind all of the co-trustees?
- What happens if a co-trustee is unavailable and a decision needs to be made quickly?
- What happens if a trustee refuses to act?
- What liability will the dissenting trustee have for the decisions of their counterparts?
- Can one co-trustee delegate a portion of his or her duties to another co-trustee?
- When does a vacancy in a trustee position occur? How are vacancies in trustee positions filled? Must a vacancy be filled or can the remaining trustee(s) act alone?

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[51] *See* UTC § 807.

[52] The UTC's treatment of delegation represents a shift in the way delegation has been traditionally viewed in trust law. "Traditional statements of this duty…have often posited a duty on the part of a trustee not to delegate the administration of the trust or the performance of acts that the trustee could "reasonably be required personally to perform." Scott, Fratcher and Ascher, 3 Scott and Ascher on Trusts § 17.3 *(citing* Restatement (Second) of Trusts § 171 (1959)).

[53] UTC § 703 (g), (h); KSA § 58a-703(g), (h); ARS § 14-40703.G and H; RSMo § 456.7-703(7)(2); MSA § 501C.0703(g)(2); Neb. Rev. St. § 30-3859(g)(2); CRS § 15-5-703(7)(b). There is some question about what constitutes a "serious" breach of trust, which may create uncertainty for the trustees. Kansas only requires that it be a breach, which is a lower standard.

[54] Please refer to the chart attached as **Appendix 2** for a comparison of state law in Texas, South Dakota, Illinois and Iowa and their provisions regarding Co-Trustees.

[55] ICA § 633A.4103.

Drafters have the ability to be as flexible as they want in drafting for specific situations, and they should take advantage of this opportunity. Any concerns a Trustee may have about liability for decisions made by others should be addressed in the governing instrument, and dissenting or abstaining Trustees should ideally be relieved of responsibility and indemnified for the action (or inaction) of the other Trustees. By clearly defining roles, Grantors can divide responsibility between Co-Trustees and avoid negative tax ramifications, as discussed in this outline.

**1. Custody of Assets**

If a corporate Trustee is serving, that entity will likely have a policy or procedure in place requiring it to have custody of all of a trust's assets, for oversight and accountability reasons.

> While acting hereunder, [the Corporate Personal Representative] **[OR]** [the Corporate Trustee] shall have sole custody of all money, securities and other personal property comprising the trust estate from time to time and of all such records pertaining to the trust as may be advisable or necessary in the administration thereof.[56]

**2. Exercise of Powers by Co-Trustees**

It's important to specify how many Trustees are needed to act on behalf of the Trust—both for the Trustees and for third parties relying on the decisions of the Trustees.

> If only two Trustees are serving, any power or discretion of the Trustees may be exercised only by their joint agreement. If more than two Trustees are serving, and unless unanimous agreement is specifically required by the terms of this Trust, any power or discretion of the Trustees may be exercised only by a majority. Despite the foregoing, if a Co-Trustee is unavailable to perform duties because of absence, illness, disqualification under other law, or other temporary incapacity, and prompt action is necessary to achieve the purposes of the Trust or to avoid injury to the Trust property, the remaining Co-Trustee if only one, or a majority of the remaining Co-Trustees if more than one, may act for the Trust.[57]

or,

> All discretionary powers to distribute principal and/or income of any trust hereunder conferred under paragraphs ______ shall be exercised by the corporate co-Trustee, in its sole discretion. No individual trustee shall participate in the exercise of such discretion.[58]

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[56] *See* UMB A-3, Paragraph C for an example.

[57] Myron Kove, George Gleason Bogert, George Taylor Bogert, Bogert's Trust and Trustees § 1065 (June 2017).

[58] 9 Nichols Cyc. Legal Forms § 217:940 (March 2017).

### 3. Tie-Breaker Provision

If only two Trustees are serving and cannot agree on a course of action, the use of a "tie-breaker" can be very helpful.

Except as otherwise specifically provided, if at any time the Trustees shall be evenly divided, the decision of the corporate [or individual] Trustee shall control. The dissenting Trustee shall have no liability for participating in or carrying out the acts of the controlling Trustee.[59]

### 4. Draft for "Sensitive Trustee"

When considering whether to name an individual as a current or a successor Trustee, drafters should make sure to be wary of inadvertently causing adverse tax consequences by allowing a beneficiary (or an individual who has a legal obligation of support towards a beneficiary) to possibly serve as Trustee, or by allowing an insured of an insurance policy owned in an ILIT to serve as the Trustee of the ILIT. Drafters can include language to anticipate those issues. Below is some sample language:

Anything herein to the contrary notwithstanding, no individual while serving as a **[**Co-Personal Representative**] [OR] [**Co-Trustee**]** hereunder shall have the right or power to participate in any decision of the Trustees with respect to any policy of insurance on such individual's life which shall constitute an asset of the trust estate (it being **[**my**] [OR] [**Grantor's**]** intent to preclude such individual from possessing any of the incidents of ownership over such policy), or with respect to any discretionary distribution to such individual Trustee, other than for such individual's health, education, maintenance and support, or to any other beneficiary which would satisfy a legal obligation of such Individual Trustee, including a support obligation.[60]

### 5. Liability of Co-Trustees

More sophisticated Trustees (both individual and corporate) will not want to be held liable for actions taken by their counterparts that they are not a part of.

No trustee shall in any event be liable to any party in interest or to any person for any act or default of any co-trustee of that trustee unless the liability results from that trustee's own bad faith or gross negligence.[61]

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[59] *See* Lauren J. Wolven, Todd A. Flubacher and Stacy E. Singer, *Do Not Feed After Midnight: Structuring and Drafting Trusts and Administration to Minimize Fiduciary Risk,* 2017 Heckerling Institute on Estate Planning at I-B-4.

[60] *See, e.g.,* UMB A-3, Paragraph E and discussion supra.

[61] 17C Am. Jur. Legal Forms 2d § 251:404 (May 2017).

**6. Appointment of Co-Trustee Provision**

Giving named Trustees the flexibility to add a Co-Trustee, who may be more experienced or better suited to handle some of the Trustee duties, to serve with them may make the position more attractive and less daunting to individual Trustees.

> Whenever in the sole judgment of trustee it becomes necessary or desirable that a co-trustee be associated with him or her in the trust, trustee or his or her successor in trust, by an instrument in writing registered or recorded in the place or places where this indenture is registered or recorded, may, without the necessity of obtaining the approval or consent of any of the holders of outstanding bonds, appoint any individual, corporation, bank, or trust company as co-trustee or as successor co-trustee, with the rights, title, powers, and duties as may be set forth in the instrument of appointment.[62]

**7. Succession of Co-Trustee**

In order to avoid a vacancy in the Trustee role and a potentially costly trip to court, the trust document should include a mechanism for Co-Trustees and successor Co-Trustees to be appointed over the lifetime of the trust.

> In the event of the death of *[Name of CO-TRUSTEE 1]* or if for any reason whatsoever he ceases to serve as Co-Trustee hereunder, the Trustors nominate and appoint *[Name of CO-TRUSTEE 2]* to serve as Trustee hereunder without the approval of any Court. In the event of the death of *[Name of CO-TRUSTEE 2]* or if for any reason whatsoever she ceases to serve as Co-Trustee hereunder, the Trustors nominate and appoint *[Name of CO-TRUSTEE 1]* to serve as Trustee hereunder without the approval of any Court. In the event of the death of both original Co-Trustees or if for any reason whatsoever both cease to serve as Trustee hereunder, the Trustors nominate and appoint *[Name of ALTERNATE CO-TRUSTEE 1]* and *[Name of ALTERNATE CO-TRUSTEE 2]*, or the survivor of them, to serve as Co-Trustees hereunder without the approval of any Court. In the event of the death of both *[Name of ALTERNATE CO-TRUSTEE 1]* and *[Name of ALTERNATE CO-TRUSTEE 2]* or if for any reason whatsoever both cease to serve as Trustee hereunder, the Trustors nominate and appoint *[Name of ALTERNATE TRUSTEE 3]* to serve as Trustee hereunder without the approval of any Court.

**8. Delegation to Corporate Trustee**

Individual Co-Trustees often would rather not have the responsibility for the trust's investments, tax preparation or accounting, especially if a corporate Co-Trustee is then serving.

> At any time and from time to time any Individual trustee is authorized to delegate to the Corporate Trustee the exercise of any or all powers, discretionary or otherwise, and to revoke any such delegation at

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[62] 3A Nichols Cyc. Legal Forms § 50:862 (November 2016). UTC § 816(20) also permits a trustee in its discretion to appoint a trustee to act in another jurisdiction with respect to trust property located in the other jurisdiction, confer upon the appointed trustee all of the powers and duties of the appointing trustee, require that the appointed trustee furnish security, and remove any trustee so appointed. *See* corresponding statutes in the states which have adopted the UTC.

will. The delegation of any such power, and also the revocation of any such delegation, shall be evidenced by an instrument in writing executed and acknowledged and delivered to the Corporate Trustee. So long as any such delegation is in effect, any of the powers, discretionary or otherwise, hereby granted and so delegated may be exercised and action may be taken by the Corporate Trustee with the same force and effect as if the Trustee delegating such power had personally joined in the exercise of such power and the taking of such action.[63]

**9. Establishing an Investment Co-Trustee**

If the Trust holds any specialized assets, such as closely held stock, a low-basis concentrated asset, or stock in the corporate Trustee itself, a corporate Trustee may not want to have investment responsibility, and the accompanying liability, for those assets. The appointment of an Investment Co-Trustee who would be responsible for those assets might be a viable solution.

Investment Co-Trustee. The following provisions of this Section shall apply to all investments then held in the Trust or any trust created hereunder, notwithstanding anything else herein to the contrary, including but not limited to the provisions of ARTICLE ___________ and despite the general powers of my corporate Trustee:

(a) During Such Time That an Investment Co-Trustee is Serving. During such time that an Investment Co-Trustee is serving under this Trust Agreement, the following provisions shall apply:

(1) Written Directions. The Investment Co-Trustee, as herein designated, shall be solely responsible to provide written directions to the corporate Trustee with respect to the purchase, sale, or encumbrance of trust principal and the investment and reinvestment of funds held hereunder (including the investment or reinvestment in whole life insurance, universal life insurance, or variable life insurance and the investment or reinvestment of funds held in such life insurance policies), and the corporate Trustee shall have no responsibility or liability for these duties during such time that an Investment Co-Trustee is serving.

(2) Trustee Accountability. No corporate Trustee shall be accountable for any loss or depreciation in value sustained by reason of action
(i) taken at the direction of the Investment Co-Trustee or
(ii) not taken by reason of disapproval by the Investment Co-Trustee pursuant to the preceding provisions of this Section, and no person dealing with my corporate Trustee shall be required or privileged to inquire whether there has been compliance with those provisions.

(3) Delegation. The Investment Co-Trustee acting hereunder may, from time to time for limited periods of time, delegate to any other person (including my corporate Trustee, with the corporate Trustee's consent) (the "Temporary Investment Co-Trustee") any or all of my Investment Co-Trustee's rights, powers, duties and responsibilities under this Section, by written notice delivered to the corporate Trustee. In the case of any such delegation, the Temporary Investment Co-Trustee may take any action or make any decision for the Investment Co-Trustee making that delegation, within the scope of the delegated rights, powers, duties and responsibilities, with the

[63] *See, e.g.,* UMB A-3, Paragraph D.

same effect as if the Investment Co-Trustee making that delegation had participated in that action or decision. The Investment Co-Trustee may remove the Temporary Investment Co-Trustee by written instrument delivered to the Temporary Investment Co-Trustee. Upon the resignation or removal of the Temporary Investment Co-Trustee, the Investment Co-Trustee shall serve in that capacity. Notwithstanding the other provisions of this Section ______, if the Investment Co-Trustee:

(i) resigns under the provisions of Section ________ of this ARTICLE,
(ii) is disqualified, under the provisions of Section ________ of this ARTICLE, or
(iii) dies,

then the Investment Trustee shall be determined in accordance with the provisions of Section _____ of this ARTICLE.

(4) Resignation. The Investment Co-Trustee acting hereunder may resign at any time by delivering not less than thirty (30) days' written notice (unless such 30-day period is waived by the party receiving notice) to the then serving Trustee(s) and a majority in interest of the beneficiaries (or their lawful guardians) who are then eligible to receive income or principal distributions from my Trust.

(5) Disqualification. The Investment Co-Trustee shall become disqualified to serve in that capacity hereunder if the corporate Trustee hereunder is in possession of either:

(i) Court Order. A currently applicable court order stating that the Investment Co-Trustee is legally incapacitated or appointing a guardian to act for such Investment Co-Trustee or appointing a conservator to manage such Investment Co-Trustee's property; or

(ii) Medical Certification. A currently applicable written certificate from a medical doctor certifying that he or she has examined such Investment Co-Trustee and has concluded that such Investment Co-Trustee is unable to handle his or her own financial affairs.

(6) Fiduciary Powers. The rights, powers, duties and responsibilities herein conferred on the Investment Co-Trustee shall be exercisable only in a fiduciary capacity and shall be limited to those described in this Section.

(b) During Such Time That No Investment Co-Trustee is Serving. During such time that no Investment Co-Trustee is serving under this Trust Agreement or any trust created hereunder, the provision of this Section shall not apply to such trust.

(c) Designation of Investment Co-Trustee. _____________ shall be the Investment Co-Trustee under this Trust Agreement and any trust created hereunder. If ________________ dies, resigns, is removed, or otherwise becomes disqualified to act as the Investment Co-Trustee, then a successor Investment Co-Trustee may be appointed by a majority in interest of the beneficiaries (or their legal guardians) who are then eligible to receive income principal distributions from such Trust.

## VI. DELEGATION

Until relatively recently, the delegation of most functions, including investment and management functions, by a Trustee to a third party was strictly forbidden.[64] However, in the early 1990's, both the American Law Institute ("ALI") and the National Conference of Commissioners on Uniform State Laws ("NCCUSL") turned the existing law upside down by moving away from the "prudent man standard" towards the Prudent Investor Rule, to be consistent with what had become current investment practice.[65] The Restatement (Third) of Trusts: Prudent Investor Rule and the Uniform Prudent Investor Act were both created in part to allow and legitimatize a Trustee's delegation of investment and management decisions.[66]

It is important to remember that while trust law has accepted the delegation of certain administrative and investment functions, it still does not permit the delegation of discretionary functions. A Trustee may only delegate the entire administration of a trust in certain limited circumstances, such as when an individual Trustee is on vacation or travelling overseas.[67] Furthermore, even if the Trustee exercises strict oversight, the Trustee still cannot delegate some specific functions, such as using discretion as to how income and principal may be used to carry out a Grantor's intent.[68]

In today's trust world, it is common to see a governing instrument which expressly authorizes the Trustee to delegate certain duties and powers, including investment functions, to others. This could allow either delegation to a co-trustee, as discussed earlier in this outline, or delegation to a third party. In many instances, delegation involves a contractual relationship between the Trustee and another party to perform certain administration services on behalf of the Trustee. In those instances, the third party acts as an agent of the Trustee.

Unlike a delegation between co-trustees, delegation to a third party involves some special considerations:

- The Trustee may have a duty to monitor or supervise the advisor/agent;
- The Trustee retains the ability to exercise independent discretion with respect to the services provided by the advisor/agent;
- The Trustee has the power to select, remove and/or appoint the advisor/agent; and
- The Trustee may be liable for the actions of the advisor/agent.

While in many instances, the governing instrument will authorize the Trustee to delegate certain administrative functions, in the absence of a provision authorizing delegation, or a provision denying or limiting trustee delegation, the applicable governing law will generally permit delegation where appropriate.[69]

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[64] Page 1 of the Prefatory Note to the UPIA states "the much criticized former rule of trust law forbidding the trustee to delegate investment and management functions has been reversed. Delegation is now permitted, subject to safeguards." *See also* Rounds, Loring A Trustee's Handbook at § 6.1.4.
[65] Prefatory Note to the UPIA, page 1.
[66] Introduction to Restatement (Third) of Trusts; Prefatory Note to the UPIA.
[67] Restatement (Third) of Trusts § 80, cmt. c; Rounds, Loring A Trustee's Handbook at § 6.1.4.
[68] Restatement (Third) of Trusts §80, cmt. f(3); Rounds, Loring A Trustee's Handbook at § 6.1.4.
[69] *See* **Appendices 3-5** for a summary of selected state delegation statutes.

## A. Delegation of Investment and Management Functions under the UTC

Under the UTC, a Trustee is liberally permitted to delegate functions that a prudent trustee of comparable skills could delegate under the circumstances.[70] For example, it may be advisable for an individual trustee to delegate to a third party certain administrative (e.g., record keeping or custody of assets) or reporting duties, but this would be unnecessary for most corporate trustees.[71] While this provision makes it easier for an individual without expertise to delegate investment responsibility, it may have the opposite effect and prohibit many corporate trustees from using this delegation provision if the corporate trustee has investment expertise. Unless the delegation is to another investment manager with greater expertise in that particular area, it would not be likely that a prudent corporate trustee would delegate to someone with equal or less capability.

Under the UTC, even if a delegation is appropriate, the trustee must use reasonable care, skill and caution in selecting the agent, setting the scope of the delegation (consistent with trust purposes and terms), and periodically reviewing the agent's actions to gauge the agent's performance and compliance.[72] If the trustee does so, the trustee is generally not liable to the beneficiaries of the trust for the agent's acts.[73]

This may be cumbersome for many Trustees and almost impossible for others. For example, if an individual Trustee who does not have investment expertise delegates the investment responsibility to a third party, how is the individual Trustee now supposed to properly review the agent's performance when the individual Trustee still does not have the required investment expertise? The agent, however, does owe a duty to the trust to exercise reasonable care to comply with the terms of the delegation and submits to the state court's jurisdiction.[74]

## B. Delegation of Investment and Management Functions under the UPIA

In states which have not adopted the UTC,[75] and even in states which have adopted the UTC,[76] the UPIA is an important resource and should also be reviewed in order to determine what duties are properly delegable, what due diligence must be conducted both before and after the delegation has occurred, and the liability of the trustee for acts of the agent.

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[70] UTC § 807(a). *See e.g.,* ARS § 14-10807; KSA § 58a-807(a); MSA § 501C.0807; and RSMo § 456.8-807.1. Please note that Nebraska did not adopt § 807 of the UTC and instead directs that delegation should be covered entirely by Nebraska's version of the UPIA. *See* Neb. Rev. St. § 30-3872.

[71] UTC § 807 (Comment).

[72] *See e.g.,* RSMo § 456.8-807.1; KSA § 58a-807(a); ARS § 14-10807; MSA § 501C.0807; Neb. Rev. St. §§ 30-3872 and 30-3888; CRS § 15-5-807(1). *See also* 760 ILCS 5/4.10 and 5/5.1; SDCL § 55-5-16; and Tex. Prop. Code §§ 113.018 and 113.85 for non-UTC examples.

[73] *See, e.g.,* RSMo § 456.8-807.1(3); KSA § 58a-807(d); ARS § 14-10807(c); CRS § 15-5-807(3); 760 ILCS 5/5.1(c); and MSA § 501C.807(c).

[74] *See e.g.,* RSMo § 456.8-807.1(2) and (4); KSA § 58a-807(c) and (e); ARS § 14-10807 (B) and (D); (4); MSA § 501C.0807(b) and (d); and Neb. Rev. St. § 30-3888(b) and (d). *See also* 760 ILCS 5/5.1 (b)(5) for a non-UTC state example.

[75] *See* **Appendix 5** for a summary of state delegation statutes in states which have not adopted the UTC.

[76] Even in states which have adopted the UTC, the UPIA may still control. In fact, the Kansas version of the UTC states that the UPIA controls over any contrary provisions of the Kansas UTC with regard to the investment and management of trust assets. KSA § 58a-807(b).

Under Section 9 of the UPIA, a trustee is permitted to delegate investment and management functions so long as a hypothetical "prudent fiduciary of comparable skills" could properly delegate investment and management functions under the same circumstances.[77] The UPIA rule was taken from The Restatement of Trusts 3d: Prudent Investor Rule (1992) § 171 (now § 80) Duty with Respect to Delegation.

Quoting from the Restatement, the comments to § 9 of the UPIA state:

> "A trustee has a duty personally to perform the responsibilities of trusteeship except as a prudent person might delegate those responsibilities to others. In deciding whether, to whom, and in what manner to delegate fiduciary authority in the administration of a trust, and thereafter in supervising agents, the trustee is under a duty to the beneficiaries to exercise fiduciary discretion and to act as a prudent person would act in similar circumstances."

Therefore, absent a provision specifically authorizing such a delegation, this would appear to prohibit a trustee which has investment expertise from delegating its responsibility to a third party.

As with the UTC, the UPIA requires a trustee to exercise reasonable care, skill and caution in selecting an agent, establishing the scope and terms of the delegation, consistent with the purposes and terms of the trust and periodically reviewing the agent's actions in order to monitor the agent's performance and compliance with the terms of the delegation.[78] Some states go further. Illinois and Kansas require that, if delegating investment management to an agent, the Trustee "must conduct an inquiry into the experience, performance history, professional licensing or registration, if any, and the financial stability of the investment agent."[79] Once that has been accomplished, and the Trustee is satisfied with the qualifications of the agent, the Trustee must send a written notice of the Trust's intention to begin delegating investment functions to each income beneficiary at least 30 days before the delegation begins.[80] On the other hand, trustees of South Dakota Trusts must merely "avoid gross negligence or willful misconduct in the selection of an agent to avoid liability," which is a relatively easy standard to meet.[81]

### C. <u>Delegation as a Matter of Discretion</u>

Because there are some significant risks in delegating administrative functions to a third party, particularly for a corporate Trustee, Grantors should bear in mind that delegation by the Trustee is within the Trustee's discretion. Thus, a grantor who intends a certain result may be dissatisfied with leaving the decision to delegate or not in the Trustee's hands, as the Trustee may easily end up deciding that the better course of action would be not to delegate. Grantors and beneficiaries should expect that if they wish the Trustee to, for example, use its discretion to delegate investment management to a third party, at the very least, the Trustee may want direction from

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[77] *See e.g.*, ARS § 14-10907; KSA § 58-24a09(a); CRS § 15-1.1-109(a); MSA § 501C.0901; Tex. Prop. Code § 117.011(a); Neb. Rev. St. § 30-3888(a); RSMo § 469.909.1.
[78] UPIA § 9(a).
[79] 760 ILCS 5/5.1(b)(2); KSA § 58-24a09(a)(2).
[80] KSA § 58-2409(a)(2) and KSA § 58-2409(a)(3).
[81] SDCL § 55-5-16.

interested parties, such as beneficiaries, with an indemnification and hold harmless agreement for the Trustee to minimize risk of liability for the Trustee.[82]

The following are some sample provisions that may be used in a Consent to Delegation of Investment Functions to be signed by the beneficiaries of the trust.

**Direction of Beneficiaries**. The Beneficiaries hereby direct, consent to and authorize that the Trustee delegate the investment functions relating to the Trust ("Investment Functions") to [Name of Third Party Investment Manager], and its successors by merger, consolidation or otherwise [Name of Third Party Investment Manager], until such time as any one or more of the Beneficiaries, if living and legally competent, shall otherwise direct the Trustee in writing, or until such time as terminated by [Name of Third Party Investment Manager]. The Investment Functions shall include but not be limited to: the determination of investment strategy, policy and asset allocation, providing written directions to the Trustee with respect to the purchase, sale, or encumbrance of Trust assets and the investment and reinvestment of funds held in the Trust. The Beneficiaries do further direct, consent to and authorize the Trustee:

a) To sign the Delegation of Investment Functions Agreement ("Delegation");

b) To, pursuant to the terms of such Delegation, invest the assets of the Trust in accordance with the directions of [Name of Third Party Investment Manager];

c) To have no duty to nor to take any action whatsoever to: (1) independently determine or verify that [Name of Third Party Investment Manager] is an appropriate party to manage the investments; (2) review the scope and terms of the engagement of [Name of Third Party Investment Manager] to perform the investment functions and manage the investments or determine that such arrangement is consistent with the terms of the Trust Agreement; (3) periodically review [Name of Third Party Investment Manager]'s actions in order to monitor its performance and compliance with the terms of its engagement; or (4) inquire into the experience, performance history, professional licensing or registration, if any, and financial stability of [Name of Third Party Investment Manager].

d) To complete and sign such investment management or similar agreement with [Name of Third Party Investment Manager], as [Name of Third Party Investment Manager] shall from time to time direct, and any other agreement, form or other documentation as [Name of Third Party Investment Manager] may from time to time request;

e) To pay from the Trust the fees of [Name of Third Party Investment Manager] or other investment managers (which shall be in addition to the fees charged by the Trustee) in accordance with such investment management or similar agreement; and

f) To take such further actions as may be necessary or convenient for [Name of Third Party Investment Manager] to provide the Investment Functions of the Trust, without custody of such investments (custody of such investments to be retained by Trustee);

All notwithstanding any provision of the Trust Agreement, any statute or rule of law, and any trust or other policy or procedure of Trustee, to the contrary. The Beneficiaries further understand and agree that the Trustee shall not be liable or responsible for any loss resulting to the Beneficiaries, or any of them, the

[82] South Dakota addresses the right of the Trustee to seek the prior approval from all known beneficiaries of the trust or from the court before delegating a portion of its fiduciary authority. SDCL § 55-5-16.

Trust, any trust created under the Trust Agreement or to any present or future beneficiary thereof by reason of following the foregoing provisions at the directions of [Name of Third Party Investment Manager], or by reason of failure to take any other action in the absence of such directions, it being the intention of the Beneficiaries to relieve the Trustee of any duties and responsibilities with respect to the Investment Functions, including but not limited to any duty the Trustee may have to apply to any court for instructions notwithstanding the fact that the Trustee has, or with reasonable inquiry should have, actual or constructive notice that any action taken or omitted pursuant to, or as a result of, the exercise of such directive authority constitutes, or may constitute, a breach of the terms of this Trust Agreement or a violation of any law applicable to the investment of the funds held thereunder.

**Consent to Investment**. The Beneficiaries also consent to authorize the investment by [Name of Third Party Investment Manager], pursuant to the terms of the Delegation, of any portion or all of the assets comprising the Trust in any one or more private investment funds or other investments managed or sponsored by [Name of Third Party Investment Manager]. The Beneficiaries understand that investments in private investment funds pose certain risks not always associated with investments in other investment vehicles, and that private investment funds are designed only for certain classes of investors known as "accredited investors" as defined in the Securities Act of 1933 or "qualified purchasers" as defined in the Investment Company Act of 1940.

In addition to obtaining the beneficiaries' consent to the delegation, the Trustee should also enter into a formal contractual relationship with the agent to whom the function in being delegated. The written agreement with the agent must be carefully drafted and should address the following matters:

1. The agent should acknowledge receipt of the governing instrument and the applicable statutory law.
2. The agent should agree to accept the delegation pursuant to the applicable governing law, the terms of the governing instrument, and in the instance where investment management is being delegated, the trustee's investment policy.
3. The agent should agree to act in accordance with the terms of the governing instrument and applicable governing law.
4. The agreement should specify how the agent is to report to the trustee and beneficiaries, if appropriate, and should specify the frequency and format of the reports. If an investment management delegation, there should be an agreement concerning the investment objectives, asset allocation, appropriate measuring benchmarks, and reporting requirements.
5. An agreement to meet periodically with the trustee and beneficiaries, if appropriate, to review the services of the agent. If an investment manager, the review should include the investment objectives, asset allocation and investment performance.
6. The trustee should have the right to remove the agent for any reason after appropriate notice to the agent.

7. The trustee should consider including an indemnification provision from the agent for the agent's acts outside the scope of the delegation.[83]

The following are some sample provisions that may be useful in a Delegation of Investment Functions Agreement.

**Delegation of Investment Functions**. The Trustee agrees to delegate the investment functions under the terms of the Trust to [Name of Third Party Investment Manager]; provided, however, the Trustee may terminate this delegation of investment function at any time with or without cause. Pursuant to such delegation, [Name of Third Party Investment Manager] shall have sole responsibility for all investment functions that would otherwise be the responsibility of the Trustee of the Trust, including but not limited to the determination of investment strategy, policy and asset allocation, providing written directions to the Trustee with respect to the purchase, sale, or encumbrance of Trust assets and the investment and reinvestment of funds held pursuant to this delegation, during the term of such delegation. Trustee will maintain custody of the Trust assets. [Name of Third Party Investment Manager]'s investment responsibilities with respect to the Trust assets subject to this delegation include, but are not limited to, making investment decisions in accordance the terms of the Trust Agreement, applicable law and the investment objectives and assets allocations established by [Name of Third Party Investment Manager].

**Acceptance and Acknowledgement**. By signing this Agreement, [Name of Third Party Investment Manager] accepts the delegation of the investment functions of the Trust and further acknowledges and agrees that [Name of Third Party Investment Manager]: (i) must perform the investment functions in accordance with the terms of the Trust Agreement and applicable law, (ii) has received and reviewed a copy of the Trust Agreement; (iii) is serving as a fiduciary of the Trust and agrees to use the appropriate skill, care and caution that comes with being a fiduciary; (iv.) that [Name of Third Party Investment Manager] is responsible for ensuring that its performance of the investment functions is in compliance with the duties associated with being a fiduciary, including, but not limited to, the duty of loyalty, and further agrees to take any necessary actions and obtain any necessary consents (other than the Consent of Beneficiaries dated ________) to avoid any improper conflicts of interest; and (5) agrees to provide the Trustee any information requested by the Trustee relating to the Trust and the actions of [Name of Third Party Investment Manager] pursuant to the terms of this Agreement, provided that such requests are reasonable.

**Indemnity and Release of Claims-Investment Agent**. [Name of Third Party Investment Manager] agrees to, and does hereby release, hold harmless and indemnify, Trustee, individually and as Trustee of the Trust, and the employees, officers, and directors of Trustee from any claims, judgments, damages, costs, liabilities, interests, penalties, losses, and expenses, including reasonable attorney's fees and court costs, that arise directly or indirectly from or in connection with the delegation of the investment functions of the Trust to [Name of Third Party Investment Manager].

[83] *See* Charles D. Fox IV and Thomas W. Abendroth, *Trustee Liability for Investments A Review of the Current State of the Prudent Investor Rule, Delegation, and Direction,* April 6, 2017 at 31.

## D. Considerations When Delegating Investment Functions

A trustee who delegates investment and management duties must consider the following:

1. The over-riding requirement contained in the Prudent Investor Act that total investment costs must be reasonable in light of the facts and circumstances.[84]
2. The trustee must exercise reasonable care in selecting the investment agent.[85]
3. The trustee must carefully consider and establish the scope and terms of the delegation.[86]
4. The Trustee must conduct a periodic review of the agent's conduct to confirm investment performance and ensure that the agent is in compliance with the scope and terms of the delegation.[87]
5. In addition, while not required in every state, it would be a good practice for the trustee to "inquire into the experience, performance history, errors and omissions coverage, professional licensing or registration, if any, and financial stability of the investment agent."[88]

## E. Issues with Delegating to an Affiliate

Whether an affiliate of the Trustee can serve as investment manager of an irrevocable trust where a corporate Trustee is serving as a Trustee will depend on the terms of the governing instrument and the applicable state law. If the governing instrument does not specifically provide for the appointment of an affiliate to serve as investment manager, generally the appointment of an affiliate to serve in that role would be in violation of the Trustee's fiduciary duties. The nature of the breach and its impact will depend on the applicable state law.

The following broader trust concepts will also impact the decision to delegate authority to an affiliated entity.

### 1. UTC § 802: Duty of Loyalty

As discussed earlier in this outline, UTC § 802 lays out the default rule of the Trustee's duty of loyalty to trust beneficiaries.[89] The general rule under § 802 is that the Trustee shall administer the trust solely in the interests of the beneficiaries.[90] Furthermore, a sale, encumbrance, or other transaction involving the investment or management of trust property

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[84] *See e.g.,* UPIA § 7; CRS § 15-1.1-107; 760 ILCS 5/5(a)(6); ICA § 633A.4204; KSA § 58-24a07; RSMo § 456.8-805; SDCL § 55-5-11; Tex. Prop. Code § 117.009.

[85] *See e.g.,* UTC § 807(a)(1); UPIA § 9(a)(1); CRS § 15-5-807(1)(a); 760 ILCS 5/5.1(b)(1); ICA § 633A.4206(2)(a); KSA § 58-24a09(a)(1) and § 58a-807(a)(1); RSMo § 456.8-807(1)(1); Neb. Rev. St. § 30-3888(a)(1); Tex. Prop. Code § 117-011(a)(1).

[86] *See e.g.,* UTC § 807(a)(2); UPIA § 9(a)(2); CRS § 15-5-807(1)(b); 760 ILCS 5/5.1(b)(1); ICA § 633A.4206(2)(b); KSA § 58-24a09(a)(1) and § 58a-807(a)(2); RSMo § 456.8-807(1)(2); Neb. Rev. St. § 30-3888(a)(2); Tex. Prop. Code § 117-011(a)(2).

[87] *See e.g.,* UTC § 807(a)(3); UPIA § 9(a)(3); CRS § 15-5-807(1)(c); 760 ILCS 5/5.1(b)(1); ICA § 633A.4206(2)(c); KSA § 58-24a09(a)(1) and § 58a-807(a)(3); RSMo § 456.8-807(1)(3); Neb. Rev. St. § 30-3888(a)(3); Tex. Prop. Code § 117-011(a)(3).

[88] *See, e.g.,* 760 ILCS 5/5.1(a)(2); KSA § 58-24a09(a)(2).

[89] *See, e.g.,* RSMo § 456.8-802; KSA § 58a-802; ARS § 14-10802; MSA § 501C.0802; Neb. Rev. St. § 30-3867.

[90] *See* UTC § 802(a).

entered into by the Trustee for the Trustee's own personal account or which is otherwise affected by a conflict between the Trustee's fiduciary responsibility and its personal interests is voidable by any beneficiary affected by the transaction.[91] This would, in essence, place the Trustee in a position of guaranteeing every investment decision, as a beneficiary could, at any time (subject to possible statute of limitations issues), choose to void any individual transaction. While there are a few exceptions, the delegation to an affiliate by a Trustee generally would be presumed to be a conflict of interest, in violation of the duty of loyalty, and resulting in the transaction being voidable by a beneficiary.[92]

**2. UTC § 807: Delegation by a Trustee**

The second provision of the UTC that affects a Trustee's ability to deal with an affiliate is the delegation provisions found in § 807. A Trustee may delegate duties and powers that a prudent Trustee of comparable skills could properly delegate under the circumstances.[93] However, there are two primary hurdles when trying to rely on this provision to delegate the investment functions to an affiliate. First, the language of the statute limits the use of delegation to situations where a prudent Trustee of comparable skill could properly delegate. The Comments to the UTC go further to state that "Whether a particular function is delegable is based on whether it is a function that a prudent Trustee might delegate in similar circumstance. For example, delegating some administrative and reporting duties might be prudent for a family Trustee but unnecessary for a corporate Trustee."[94] In most situations, a Corporate Trustee will have the ability and expertise to perform the investment management function, and as a result a Trustee of comparable skill would not properly delegate this function, either to an independent entity or to an affiliate.

**3. UTC § 1009: Beneficiary's Consents, Releases and Ratifications**

The third UTC section which affects the ability to delegate to an affiliate is UTC § 1009, which governs the use of consents.[95] UTC § 802 provides that a transaction that is otherwise affected by a conflict will not be voidable by a beneficiary if that beneficiary consented to the Trustee's conduct, ratified the transaction, or released the Trustee in compliance with UTC § 1009.[96] While this provision may be helpful in certain circumstances, there are at least two significant limitations that may limit its usefulness with respect to delegation to affiliates. The first major limitation is that the transaction is voidable under UTC § 802 by any beneficiary that is affected by the transaction.[97] As a result, in order for the beneficiary's

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[91] *See* UTC § 802(b).
[92] Note that there are a few exceptions to this rule but none would appear to apply to the appointment of an investment advisor.
[93] *See* UTC § 807(a); UTC § 804; ARS § 14-10807; KSA § 58A-807; MSA § 501C.0807; RSMo § 456.8-807; Neb. Rev. St. § 30-3872.
[94] https://www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=e9c00113-601a-cd94-3aec-97c75a9f6d5a&forceDialog=0.
[95] UTC § 1009; ARS § 14-1009; KSA § 58a-1009; MSA § 501C.1009; RSMo § 456.10-1009; Neb. Rev. St. § 30-3898.
[96] *See* UTC § 802(b)(4).
[97] *See* the Comments to UTC § 802 which provide in part "A transaction affected by a conflict between the Trustee's fiduciary and personal interests is voidable by a beneficiary who is affected by the transaction."

consent to properly limit the liability, the consent must be obtained from ***all*** ***beneficiaries***, which often presents a challenge. The second major limitation is that pursuant to UTC § 1009, the consent will not relieve the Trustee from liability if, at the time of the consent, the beneficiary did not know of the beneficiary's rights or of the material facts relating to the breach.[98] In order to be valid, the consent must be an affirmative act on behalf of the beneficiary and that a failure to object (or negative consent) is not sufficient.[99] It is often difficult to determine if all of the material facts have been disclosed and understood by the beneficiary.

### F. Liability of Trustee and Agent

Both the UTC and the UPIA provide that the agent who is performing a delegated function owes a duty to the trust to exercise reasonable care to comply with the terms of the delegation.[100] Because the agent has a duty to the trust, trust beneficiaries have recourse against the agent for violating this duty. The UTC and the UPIA further provided that by accepting the delegation of a trust function from the trustee of a trust subject to state law, the agent submits to the jurisdiction of the courts of that state.[101] Therefore, if the trust for which investment and management functions are delegated is subject to Kansas law, the investment agent, by accepting the delegation, becomes subject to the jurisdiction of Kansas courts.[102]

On the other side, if a trustee complies with the requirements outlined earlier in this section when delegating investment and management functions, the trustee is no longer liable to the beneficiaries or the trust with respect to the functions delegated.[103] The trustee fulfills the trustee's duty by exercising reasonable care in selecting the investment agent and observing the other formalities imposed by the UPIA. The trust and beneficiaries are not without remedy, however, because the investment agent bears the risk of liability for delegated investment functions, as noted above.

The requirements under the delegation provisions of the governing instrument and/or the applicable governing law will often result in equal or greater work to the delegating Trustee with greater risk. As a result, in many instances, using a directed trust may be a better choice for many clients.

### G. Sample Provisions

While state law should provide some level of comfort with the availability of delegation as a method for bifurcating trustee duties, it would still be very helpful to include specific language in

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[98] *See* UTC § 1009.

[99] *See* Comments to UTC § 1009.

[100] UTC § 807(b); UPIA § 9(b). *See also* CRS § 15-5-807(2); ICA. § 633A.4206; RSMo § 456.8-807(2); Neb. Rev. St. § 30-3888(b); Tex. Prop. Code § 117-011(b). In Illinois and Kansas, the investment agent is subject to the same standards that are applicable to the trustee. *See* 760 ILCS 5/5.1(b)(4); KSA § 58-24a09(b).

[101] UTC § 807(d); UPIA § 9(d).

[102] *See e.g.,* KSA § 58-24a09(e).

[103] CRS § 15-5-807(3); 760 ILCS 5/5.1(c); ICA § 633A.4206(3); KSA § 58-24a09(d); Neb. Rev. St. § 30-3888. In South Dakota, if the beneficiaries of the trust or the court approves the delegation in writing, the Trustee will not be liable for the acts of the agent, except in the cases of willful misconduct or gross negligence by the delegating trustee. SDCL § 55-5-16.

the trust document to identify the scope of the desired delegation and limit trustee liability in order to increase a trustee's comfort with the idea.

### 1. Delegation to a Third Party.

The following provision typically appears in the list of Trustee's discretionary powers and authorizes the Trustee to delegate to a third party service provider. Consideration should be given whether the Trustee should be relieved of any obligation to monitor or if the Trustee should be held harmless for the actions delegated. Note that this language will generally not be sufficient to allow a corporate trustee to delegate functions it has the expertise to handle. If this is desired, specific direction language may be needed.

> To employ agents, attorneys and any other persons whose services may reasonably be required in connection with the administration of the trust estate from time to time, to delegate to them such duties, rights, and powers of the Trustee for such period as the Trustee shall think fit (including but not limited to the ability to delegate investment responsibility to such agent) and to pay reasonable compensation therefore. In addition, the Trustee may refer any legal question to legal counsel and the Trustee shall be fully protected for anything done, suffered, or omitted to be done in reliance on advice of such counsel.[104]

or,

> The Trustee may delegate investment and management functions that a prudent trustee of comparable skills could properly delegate under the circumstances. The Trustee shall exercise reasonable care, skill, and caution in:
>
> (a) selecting an agent;
>
> (b) establishing the scope and terms of the delegation, consistent with the purposes and terms of the trust; and
>
> (c) periodically reviewing the agent's actions in order to monitor the agent's performance and compliance with the terms of the delegation;
>
> In performing a delegated function, an agent owes a duty to the trust to exercise reasonable care to comply with the terms of the delegation. By accepting delegation of a trust function from the Trustee hereunder, an agent submits to the jurisdiction of the courts of the state of [name of state].
>
> If the Trustee complies with the requirements of this paragraph the Trustee shall not be liable to the beneficiaries or to the trust for the decisions or actions of the agent to whom the function was delegated.[105]

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[104] *See, e.g.,* UMB 2, Article Three, Paragraph L (modified to address delegation of investment responsibility).
[105] Bogert's Trusts and Trustees Clauses for Admin. Purposes, § 1251 Investment Clause (June 2017).

### 2. Delegation to a Family Member.

Sometimes a trust will hold a specialized asset, such as a farm or a closely held business, and the Grantor might wish for the management of that asset to be left to family members.

> The Trustee shall have the power to designate any member of my family, as defined at Section 2032A(e)(2) of the Internal Revenue Code of 1054, as amended, to actively participate with my Personal Representative or **Trustee** in the management of any farm owned by me at my death or any trust created by this will to the extent necessary to secure qualification of the same for any election or benefits extended under the Internal Revenue Code or to prevent disqualification of the same for such benefits. My Personal Representative and **Trustee** are specifically authorized to **delegate** any authority or responsibility to such member of my family which either of them deems advisable or necessary to obtain such benefits, and such fiduciaries are hereby exonerated from liability by reason of any such **delegation**. Such fiduciaries may change or substitute such designee with any other member or members of my family, from time to time. The designation of such member of my family shall be by a written statement signed by the fiduciary making such designation and shall be subject to revocation by such fiduciary at any time.

### 3. Limitation of Trustee's Liability.

If a Grantor wishes a Trustee to consider delegation, it would be helpful to include a provision in the trust document limiting the liability of the trustee for doing so.

> The Trustee shall be indemnified from any and all liabilities, costs, and expenses which may at any time be incurred by it as a consequence of its appointment of _______________ as investment manager of the trust assets. This indemnification shall be binding upon the undersigned and his or her successors, heirs and assignees.

## VII. TRUST PROTECTORS

In addition to the appointment of a Co-Trustee or the delegation to an agent, a third party may be appointed as a "trust protector" to perform certain tasks traditionally performed by the Trustee. In some instances, these parties may be serving in a fiduciary role, but many times they are designated as non-fiduciaries.[106] These special power holders are given the ability to provide directions to the trustee and can have as limited or as broad a role as the grantor wishes.

### A. <u>What is a Trust Protector?</u>

A trust protector is a non-trustee party that is appointed in the governing instrument to exercise one or more powers affecting the management of the trust and the interests of the beneficiaries.[107] In general, a trust protector is appointed to supervise and monitor the trustee's administration of the trust, to address unforeseen circumstances or changes in the law, or to amend the terms of a

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[106] The Grantor may not intend for the trust protector to protect the trust or the beneficiary. One commentator recommends that more precise terminology is to use "trust director" for powers of direction to be exercised in a fiduciary capacity and "trust appointer" for other powers to be exercised in a non-fiduciary capacity. Sherby, *"It's A Whole New Ballgame" Trust Directors With Powers of Direction! But What About Trust Protectors?* at 2.

[107] *Id.* at 4.

trust in keeping with the settlor's objectives and intent.[108] A trust protector has also been described as a person selected by the settlor to represent the settlor's interests in making specified trust decisions that the settlor will be unable to make."[109] Advantages of appointing a trust protector might include:

- Trust protectors can provide flexibility in an irrevocable trust.
- The trust protector can be given a broad array of powers that enable them to address a variety of administrative and tax issues and circumstances that may arise during the administration of the trust, such as a change in state law or tax law.
- Trust protectors can reduce the need for court actions due to scrivener's errors, changed or unanticipated circumstances, or disputes between beneficiaries and trustees.[110]

As with any other bifurcated arrangement, it is important for the estate planner to carefully consider the relationship among the grantor, the trust protector, the trustee and the beneficiaries. Additionally, it is important to consider the income tax and transfer tax implications arising from the identity of the trust protector and the powers given to the trust protector.

### B. Who Might Serve as Trust Protector?

A trust protector is an individual, or succession of individuals.[111] The individual or individuals selected may be family members, business partners, friends, attorneys, accountants or other advisors. The selection of the individual(s) to be appointed should be tied to the scope of responsibilities to be assigned to the trust protector.[112] Just like the selection of a trustee, trust advisor or other fiduciary, the specific responsibilities assigned will help identify the skills, knowledge and expertise needed in the trust protector appointed.

For example, if the trust protector is given authority to modify the trust to address changes in the applicable tax law, the trust protector appointed should have both an understanding of the tax law and how it impacts the trust. Or, if the trust protector is given authority to oversee and approve a beneficiary's exercise of a power of appointment, the trust protector should have an understanding of the family history and dynamics.

### C. When to Use a Trust Protector

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[108] *See* Jennifer A. Davis, *Using Trust Protectors* at 8, presented at the Missouri Bar's Annual Estate, Trust and Elder Law Institute on August 26, 2016. *See also* Charles A. Redd, *Directed and Delegated Trusts—The Options Available and The Risks Involved*, Cannon Financial Institute, Inc. 2016 Estate Planning Teleconference Series, presented Tuesday, October 18, 2016, at 3.

[109] Stewart E. Sterk, *Trust Protectors, Agency Costs, and Fiduciary Duty*, 27 Cardoza L. Rev. 2761 (2006) as quoted in Sherby, *"It's A Whole New Ballgame" Trust Directors With Powers of Direction! But What About Trust Protectors?* at 4.

[110] For additional discussion of the advantages of trust protectors, *see* Kohn and Romanoff, *Trust Protectors in Depth*, at 43.

[111] *See* footnote 45, *supra*. Missouri recently amended its definition of trust protector to include more than just persons (*see* RSMo § 456.8-808.2). The new definition of trust protector, while quite broad, expressly contemplates that a trust protector may also be an entity. One example where this makes sense is where a registered investment advisor firm might be contemplated to manage the trust's investments, but this party is more in the nature of a trust director. This further illustrates the need to define the third party's responsibilities by clearly defining duties and responsibilities in the trust instrument and not just relying upon a certain term to describe the party.

[112] Kohn and Romanoff, *Trust Protectors in Depth* at 49 (June 2015).

There are a number of different circumstances where appointment of a trust protector may be appropriate.[113]

1. The grantor, beneficiaries and trustee cannot hold certain powers because to do so would result in unwanted tax consequences or a breach of fiduciary duty.[114]
2. Privacy concerns may warrant granting powers normally held by the courts to reduce the chances of a public court proceeding.[115]
3. The trust holds special assets requiring particular skills, knowledge or expertise in handling.
4. The trust's term is anticipated to be long term, such as a dynasty style trust, which may last many years into the future when facts and circumstances of the beneficiaries, the economy, tax laws, etc. cannot possibly be known at the time the trust is created.[116]

## D. Trust Protector Powers

Granting a third party, such as a trust protector, specific powers provides a useful tool for grantors who wish to provide extra oversight and flexibility when the grantors are not able or available to do so. Trust protector powers may include the following:

### 1. Distribution Decisions

A trust protector can be given a veto power over distributions or can be given the power to modify or remove the withdrawal rights granted a beneficiary. A provision requiring the trust protector's consent to the exercise of a limited power of appointment can be used to protect against undue influence of the beneficiary, or the trust protector could be given the power to add and/or remove beneficiaries.[117]

### 2. Investment Decisions

The trust protector can be given the power to advise the trustee concerning the management of special assets, or the power to oversee and manage the special assets. Another option is to give the trust protector veto power over investment decisions, or the power to direct specific investments of the trust.[118]

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[113] One commentator has stated that "The initial question is whether a trust protector is necessary, as it may create additional costs to administer the trust and may also interfere with the efficient management of the trust. It may also result in a shift of duties away from the trustee to a party who may be less involved or have a less formal role with the trust." Davis, *Using Trust Protectors* at 11.

[114] *See* Sherby, *"It's A Whole New Ballgame" Trust Directors With Powers of Direction! But What About Trust Protectors?* at 26.

[115] *Id.* at 27.

[116] *Id.* at 27.

[117] *See* Kohn and Romanoff, *Trust Protectors in Depth* at 48.

[118] *Id. See also* Sherby, *"It's A Whole New Ballgame" Trust Directors With Powers of Direction! But What About Trust Protectors?* at 21.

### 3. Trustee Matters

The trust protector can be appointed to protect against a "bad" trustee or to address trustee succession issues by being granted the power to remove and replace a trustee, fill a vacancy, approve trustee compensation, or appoint a successor trustee in the future.[119]

### 4. Administrative Matters

Finally, the trust protector could be granted certain administrative powers. Some common examples include the following:

a. Power to amend the administrative provisions in the governing instrument to address changes in federal or state law, regulations or tax laws;[120]
b. Power to change the situs of the trust and its governing law;[121]
c. Power to terminate the trust if the purpose of the trust has been served, the goals are no longer achievable, or the cost of administration becomes uneconomical;[122]
d. Power to approve the Trustee's accountings;[123]
e. Power to eliminate the grantor's retained powers, thereby terminating grantor trust status.[124]

Sometimes the trust protector or special Trustee may hold powers that cannot or should not be held by the Trustee due to potential adverse tax consequences or special expertise that the Trustee might not possess or powers it might be unwilling to exercise.[125] However, there may be adverse tax consequences for trust protectors as well. For this reason, drafters should be cautious in giving

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[119] *See* Kohn and Romanoff, *Trust Protectors in Depth*, at 48–49; Sherby, *"It's A Whole New Ballgame" Trust Directors With Powers of Direction! But What About Trust Protectors?* at 22.

[120] The Trustee could also be given the power to amend the trust. *See, e.g.,* UMB 2, Article Sixteen which provides a sample of a limited power of amendment granted to the Trustee. Note that the Trustee has no duty to monitor the beneficiaries or their circumstances, applicable tax laws and other laws and changes in such laws, or any trust created hereunder in order to determine whether or not any of the powers and discretions conferred under this Article should be exercised. In addition, under these provisions and the Trustee shall not be liable for the consequences of exercising or not exercising any power or discretion granted under the power of amendment, including exercising or not exercising the power and discretion to amend, and, if amended, the terms and provisions of such amendment, but rather the Trustee shall be exonerated from any and all such liability and from any and all liability for the acts or omissions of any other fiduciary. Trust protectors may also be interested in such exculpatory type provisions as an inducement to exercise powers of amendment if granted to them.

[121] The Trustee could also be given the power to change the Trust's situs. *See* UTC § 108 and discussion *infra*. However, the Trustee would not want to have a duty to monitor the "best" choice of jurisdiction. *See, e.g.,* UMB 2, Article Twelve.

[122] *See* Kohn and Romanoff, *Trust Protectors in Depth* at 49. The Trustee can hold this power too. *See, e.g.,* UMB 2, Article Two, Paragraph G. Default rules for terminations of "small" trusts within the Trustee's discretion are also found in UTC § 414 and corresponding statutes in UTC states. Of course, these can be drafted around.

[123] Sherby, *"It's A Whole New Ballgame" Trust Directors With Powers of Direction! But What About Trust Protectors?* at 23.

[124] *Id.* at 24.

[125] Paul N. Frimmer, *The Use of Special Trustees And Trust Protectors*, ALI-ABA Estate Planning Course Materials Journal Volume 15, Number 5 at 5 (October 2011). This article contains suggested form language for the practitioner to consider.

a trust protector the power to modify the terms of a power of appointment to avoid creating the tax issues for the trust protector.[126]

## E. Potential Issues with Trust Protectors

While the primary purpose of naming a trust protector may be to solve tax and administration issues, it is important to note that, when granting a trust protector overly broad powers over the trust, the scrivener could actually be creating some unintended problems. For example,

1. conflicts among the trustee, beneficiaries and trust protector could result in litigation;
2. there could be unexpected tax consequences to the grantor, the beneficiaries, the trust protector or the trust; or
3. the initial purpose of the trust could be impacted.[127]

As a result, it is important to carefully consider the powers to be granted and the trust protector selected to serve.

## F. Trust Protectors Under State Law

While state law generally gives grantors a lot of latitude with respect to the powers he or she might want to grant to trust protectors, drafters should make sure to consult relevant state law to determine whether the powers given will be honored by a court.[128] South Dakota was a frontrunner in recognizing the concept of a trust protector in 1997,[129] and was followed in 2000 by NCCUSL, which included a provision regarding trust protectors in the UTC, although the UTC does not use the term "trust protector."[130] UTC § 808 recognizes that "the terms of a trust may confer upon a trustee or other person a power to direct the modification or termination of the trust,"[131] opening the door to the idea of a third party directing the Trustee to take an action with respect to the trust.[132] While the term "trust protector" does not appear in § 808 itself, the comment to UTC § 808 states "subsections (b)–(d) [of § 808] ratify the use of trust protectors and advisers." Several states have since adopted versions of § 808 which are substantially similar to the model law,[133] but it is important to note that in most of those states, the term "trust protector" does not appear in either the statute itself or in comments to the statute, and it is unclear whether those states recognize trust protectors or only trust advisors (as defined and discussed later in this

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[126] Davis, *Using Trust Protectors* at 9. For more discussion of the powers which may be given to trust protectors, see Redd, *Directed and Delegated Trusts—The Options Available and The Risks Involved*, at 3, and Davis, *Using Trust Protectors*, at 7. For examples of state statutes which provide examples of permissible powers to give to a trust protector, *see* ARS Rev. Stat. § 14-10818; 760 ILCS 5/16.3; MSA § 501C.0808; RSMo § 456.8-808; and SDCL § 55-1B-6.

[127] Kohn and Romanoff, *Trust Protectors in Depth* at 49.

[128] *See* Kohn and Romanoff, *Trust Protectors in Depth* at 52.

[129] SDCL § 55-1B-1 *et seq.*

[130] UTC § 808.

[131] UTC § 808(c).

[132] The comment to UTC § 808 states that subsection (b) of § 808 is based in part on Restatement (Second) of Trusts § 185 (1959).

[133] *See, e.g.,* ARS § 14-10808 (enacted in 2009); KSA § 58a-808 (enacted in 2002); and Neb. Rev. St. § 30-3873 (enacted in 2003). *See also* ICA § 633A.4207 (enacted in 2006) for a non-UTC state adopted. Iowa's version is modeled after Restatement (Second) § 185.

outline).[134] Other states have enacted statutes which incorporate provisions specifically addressing the roles of trust protectors (and using the term "trust protector"), discussing permissible powers which may be delegated to the trust protector.[135] A few states have gone on to specify what powers cannot be given to trust protectors.[136]

While Missouri originally adopted UTC § 808 which followed the model form, Missouri modified its version of § 808—first in 2012 and then again in 2018—to add provisions expressly addressing trust protectors.[137] RSMo § 456.8-808.2, as revised, now provides that "A trust instrument may provide for one or more persons, not then serving as a trustee and not the settlor or a beneficiary, to be given any powers over the trust as expressly granted in the trust instrument" and that "Any such person may be identified and appointed as a trust protector or similar term. Whenever a trust instrument names, appoints, authorizes, or otherwise designates a trust protector, the trust shall be deemed a directed trust."[138] The Missouri statute also provides that:

> Except to the extent otherwise provided in the trust instrument and in subsection 7 of this section, and notwithstanding any provision of sections 456.1-101 to 456.11-1106 to the contrary: (1) A trust protector shall act in a fiduciary capacity in carrying out the powers granted to the trust

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[134] ARS § 14-10808, Neb. Rev. St. § 30-3873 and ICA § 633A.4207 do not contain the term "trust protector". The term is not included in the body of KSA § 58a-808, but is applied to the statute in the comments to the statute.

[135] *See, e.g.,* ARS § 14-10818 (enacted in 2009); MCA § 501C.0808 (enacted in 2016); 760 ILCS 5/16.3 (enacted in 2015); SDCL § 55-1B-6 (enacted in 1997, as discussed above); Tex. Prop. Code § 114.0031 (enacted in 2015). Colorado has a directed trust statute, found at C.R.S § 15-16-801 *et seq.*, which is similar to these statutes, but appears to only apply to trust advisors, and not trust protectors. *See* Sherby, *"It's A Whole New Ballgame" Trust Directors, With Powers of Direction! But What About Trust Protectors?* at 11.

[136] *See, e.g.,* RSMo § 456.8-808 (enacted in 2012) (where a trust protector cannot be given the power to remove a government payback provision from a special needs trust, or reduce or eliminate an income interest of the income beneficiary of a trust for which a marital deduction has been taken, a charitable remainder trust, a grantor retained annuity trust, or a qualified Sub-Chapter S Trust) ; ARS § 14-10818 (enacted in 2009) (where trust protectors cannot grant a beneficial interest to an individual or a class or individuals unless that individual or class is specifically provided for under the trust instrument, or modify the beneficial interest of a government unit in a special needs trust). *See also* Sherby, *"It's A Whole New Ballgame" Trust Directors, With Powers of Direction! But What About Trust Protectors?* for an all states comparison chart for trust protector/advisor and directed trusts statutes.

[137] RSMo § 456.8-808.2–.11. These revisions were made after the Missouri case regarding trust protectors was handed down in *Robert T. McLean Irrevocable Trust v. Patrick Davis, PC*, 283 SW3d 786 (Mo. Ct. App. 2009). There, the beneficiaries claimed that the trust protector had breached his fiduciary duties by not monitoring the trustees and not acting in the best interests of the beneficiaries, which resulted in the misappropriation of trust assets. The trial court held that the trust protector had no legal duties to supervise the trustees. The Court of Appeals found that Missouri law did not impose duties on a trust protector and duties would arise from the terms of the trust document. The Court stated that some duty of care was imposed under the trust document, but that the duties and responsibilities of the trust protector were not clearly set out there. The case was reversed and remanded for the trial court to determine the intent of the trust protector. On remand, the trial court directed a verdict in favor of the trust protector. *McLean Irrev. Tr. v. Ponder*, No. 36V10500665-01 (Mo. Cir. Ct. Oct. 20, 2011), affirmed by the Court of Appeals in *McLean Irrev. Tr. v. Ponder*, 418 SW3d 482 (Mo. Ct. App. 2013). One commentator has indicated that the *McLean* case is one of the leading cases concerning trust protectors. Davis, *Using Trust Protectors* at 5. *See* Ms. Davis' materials concerning other cases regarding trust protectors and for references to other sources regarding drafting for trust protectors.

[138] RSMo § 456.8-808.2. *See also* ARS § 14-10818(A).

> protector in the trust instrument, and shall have such duties to the beneficiaries, the settlor, or the trust as set forth in the trust instrument….[139]

Missouri has amended RSMo § 456.1-103 to add a definition of trust protector.[140] Missouri has also further modified RSMo § 456.8-808 with changes that are more directed towards strengthening Missouri's statute as a "directed trust" statute. As discussed elsewhere, Missouri's use of "trust protector" in its directed trust statute may cause confusion.[141]

### G. <u>Liability of Trust Protectors—Standard of Care</u>

The standard of care for the trust protector should be addressed by the drafting attorney to determine whether such party holds its powers in a fiduciary or non-fiduciary capacity.[142] While most states consider trust protectors to be fiduciaries, Arizona and South Dakota operate under the presumption that the trust protector is not a fiduciary unless the trust document specifies otherwise.[143] The trust protector or special Trustee may not be willing to serve unless it is exculpated from liability if it acts within the applicable standard.[144] If the trust document is silent, the majority of states consider a trust protector to be a fiduciary. UTC § 808 states "a person, other than a beneficiary, who holds a power to direct is presumptively a fiduciary who, as such, is required to act in good faith with regard to the purposes of the trust and the interests of the beneficiaries. The holder of a power to direct is liable for any loss that results from breach of a fiduciary duty."[145] The current Missouri statute also affirms that a trust protector is a fiduciary but is exonerated from any and all liability for his or her acts or omissions unless it is established by a preponderance of the evidence that such acts or omissions were done or omitted in breach of the trust protector's duty, in bad faith, or with reckless indifference.[146] Illinois and Minnesota are among the states whose statutes subject the trust protector to the same standard of care as that which would apply to a Trustee, unless the trust document provides otherwise. However, in those

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[139] RSMo § 456.8-808.6.

[140] *See* discussion at footnote 45, *supra*.

[141] *Id*. *See* Missouri H.B. 1250 (2018)..

[142] *See* Frimmer, *The Use of Special Trustees And Trust Protectors* at 6.

[143] ARS § 14-10818(D); SDCL § 55-1B-1. South Dakota does have an exception from the non-fiduciary presumption, in cases where the trust protector is exercising the authority of an investment trust advisor or a distribution trust advisor.

[144] Frimmer, *The Use of Special Trustees And Trust Protectors* at 7. *See also* RSMo § 456.8-808.6(1) which provides that except as otherwise provided in the trust instrument and except as provided in RSMo § 456.8-808.7 (relating to investment decisions by a trust protector) a trust protector shall act in a fiduciary capacity in carrying out the powers granted to the trust protector in the trust instrument. Missouri's recent change to such section goes on to state that "provided, however, that the trust instrument may provide that the trust protector shall act in a nonfiduciary capacity." Depending on the nature of the powers granted to the trust protector, a Trustee may not be willing to accept a trust appointing a "trust protector" which holds typically fiduciary powers, such as those relating to investments and distributions, if it is not clear that the third party is acting as a fiduciary (although the existing Missouri statute does attempt to deal with issues relating to investments). See footnote 141 for a reference to the Missouri Bill.

[145] UTC § 808(d). *See also* ARS § 14-10808(d); ICA § 633A.4207(3); KSA § 58a-808; Neb. Rev. St. § 30-3873(d); SDCL § 55-1B-4.

[146] RSMo § 456.8-808.6(2).

cases, grantors may not relieve or exonerate the trust protector from the duty to act or withholding acting as the trust protector in good faith reasonably believes is in the best interests of the trust.[147]

## H. Liability of Trustees—Standard of Care

If a potential trustee is considering serving as the trustee of a trust which involves a trust protector, that trustee will most likely be very interested in what liability that trustee might be subject to for following the directions of the trust protector. Again, drafters should be as specific as possible in setting forth what a trustee's liability could be for the acts of the trust protector. UTC § 808 provides that the trustee should act in accordance with the trust protector's exercise of power "unless the attempted exercise is manifestly contrary to the terms of the trust or the trustee knows the attempted exercise would constitute a serious breach of a fiduciary duty that the person holding the power owes to the beneficiaries of the trust."[148] However, some states felt the need to modify the wording of this provision to further exculpate trustees, highlighting the importance of trustee liability in this area.[149]

## I. Drafting for Trust Protectors

A trust protector can only be appointed under the terms of a trust document, and the trust protector must operate under the framework of powers and duties which were provided by the grantor. While the UTC and state law is a guide for drafters when drafting the trust documents, it cannot be used as a default, unlike with other mechanisms of bifurcation covered in this outline. Therefore, it is important that the trust document include specific provisions concerning the following:

1. Describe, in detail, the powers to be given the trust protector.
2. Specify whether the trust protector is a fiduciary or not (e.g., only liable for wrongful acts or acts of self-dealing), whether that status only applies to specific powers, and whether or not the trust protector should be indemnified for actions taken or for failing to act.
3. Specify how the trust protector and trustee are expected to interact and communicate.
4. Address the duties of the trustee with regard to the trust protector (e.g., no duty to monitor performance of trust protector; duty to follow instructions, and address liability of trustee when following direction of trust protector).
5. The trust instrument should also address the following:
    a. The trust protector's rights, succession and compensation;
    b. Whether the trust protector should have access to statements or accountings;

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[147] 760 ILCS 5/16.3(e); MSA § 501C.0808(5).
[148] UTC § 808(b). *See also* KSA § 58a-808; Neb. Rev. St. § 30-3873.
[149] Arizona specified "the trustee has no duty to review the directions it is directed to make or to notify the beneficiaries regarding any investment action taken pursuant to the direction. The trustee is not responsible for the purchase, monitoring, retention or sale of assets that are subject to the direction of …[a] third party. The trustee is not subject to liability if the trustee acts pursuant to the direction, even if the actions constitute a breach of fiduciary duty, unless the trustee acts in bad faith or with reckless indifference." ARS § 14-10808(B). *See also* Tex. Prop. Code § 114-0031(g) and SDCL § 55-1B-2 (requiring willful misconduct or gross negligence on the part of the Trustee).

c. Whether the trust protector can consult with an attorney or accountant with the trust bearing the cost; and
d. Which party or parties can designate a successor trust protector, if any.

### J. **Sample Provision**

The following is a sample trust protector provision for scriveners to consider:

The initial Trust Protector shall be [*name of initial trust protector*] of [*name of city*], [*name of state*]. If [*name of initial trust protector*] shall be or become unwilling or unable for any reason to serve as Trust Protector, then [*name of successor trust protector*] of [*name of city*], [*name of state*], shall succeed to the office of Trust Protector. The Trust Protector is empowered to perform any or all of the acts described in (a) through (e) below, provided, however, that the Trust Protector shall only perform any one or more of such acts if the Trust Protector receives a written notice either specifically requesting him to so act or advising him that circumstances have arisen which may require such action. The Trust Protector shall have no affirmative duty to act at all and no duty or responsibility either to monitor the investment performance of the Trustee or handle the investments of any of the trusts created under this instrument, nor to monitor the office of trustee so as to determine whether there is a vacancy in said office. No Trust Protector acting hereunder shall be accountable for any act or default of, or have any responsibility for, the acts or defaults of any Trustee or any predecessor Trust Protector, nor shall any Trust Protector be liable or responsible for any loss or damage resulting from such Trust Protector's own acts or defaults, including any loss or depreciation in value sustained by the Trust as a result of the retention or acceptance of any property upon where there is later discovered to be hazardous materials or substances requiring remedial action pursuant to any federal, state, or local environmental law, except as may be caused by such Trust Protector's bad faith, gross negligence or willful misconduct.

The Trust Protector shall not be held liable for any act or failure to act unless such act or failure to act was the result of the Trust Protector's reckless conduct, bad faith, or intentionally improper conduct. The Trust Protector may decline to exercise its power, and such refusal shall not of itself be deemed to be reckless or intentionally improper conduct, nor bad faith.

The Trust Protector shall have the power, in its sole discretion, to:

(a) change the governing law applicable to the Trust and remove the Trust from [*state of governing law*];

(b) question the fees of any corporate trustee and approve, in writing, any Trust or Trustee termination fee;

(c) remove a Trustee with or without cause;

(d) appoint a successor Trustee to fill any vacancy in the office of Trustee provided, however, that this power shall only be exercisable if there is no successor Trustee specifically named in this Trust who is both able and willing to serve and has not previously been removed as Trustee; and

(e) name one or more successor Trust Protectors who shall serve following the time there is no remaining Trust Protector specifically named in this Trust who is willing and able to fill a vacancy in the office of Trust Protector, and designate the order in which such successors shall serve.

In the event there is a vacancy in the office of Trust Protector and no provision has been made herein to fill such vacancy, the then acting Trustee shall appoint a Trust Protector provided, however, that a Trust

Protector so appointed shall not be a person or entity related or subordinate to such Trustee, the Donor, or any beneficiary of this Trust within the meaning of 26 U.S.C.A. § 672(c).[150]

# VIII. DIRECTED TRUSTS

## A. What is a Directed Trust?

A directed trust is a trust in which some of the duties traditionally held by the trustee are formally bifurcated, by the terms of the document, and assigned to a separate advisor. The trustee in a directed trust exercises trust power and authority only at the direction of the advisor. This division of duties allows the Grantor to use specialized advisors to administer different aspects of the trust. Note that, with a directed trust, the grantor is affirmatively providing for division of duties rather than providing for joint decision-making by Co-Trustees or leaving the decision to delegate duties to the discretion of the Trustee, who may or may not be willing to exercise such discretion.

Common characteristics of a directed trust include the following:

1. A trust that effectively bifurcates administrative functions between two parties, who are both considered fiduciaries.
2. The trustee should have no duty to monitor or supervise the advisor.
3. The trustee should have no ability to exercise independent discretion with respect to the directions received from the advisor.
4. The trustee should not have the power to select, remove or appoint the advisor.
5. The trustee should only be liable for willful misconduct when acting at the direction of the advisor and should have no responsibility for any breach of duty committed by the advisor.

It should be noted that a power to direct is different from a veto power. The comments to UTC § 808 provide that:

> A power to direct involves action initiated and within the control of a third party. The trustee usually has no responsibility other than to carry out the direction when made. But if a third party holds a veto power, the trustee is responsible for initiating the decision, subject to the third party's approval. A trustee who administers a trust subject to a veto power occupies a position akin to that of a cotrustee and is responsible for taking appropriate action if the third party's refusal to consent would result in a serious breach of trust.[151]

## B. Bifurcation of Duties

While there are generally no limitations on the specific duties and responsibilities that may be bifurcated, the following duties are most commonly the subject of a bifurcation:

### 1. Investment Management

An advisor is appointed to direct, consent to or disapprove a trustee's actions with respect to investments, generally or with regard to specific assets. This type of bifurcation is commonly

[150] 3A McGaffey Leg. Fms. With Tax Analysis § 16:115 (April 2017).
[151] The Comment cites Restatement (Second) of Trusts § 185 cmt. g (1959); UTC § 703(g) (duties of cotrustees).

used for trusts holding unique or hard-to-value assets (e.g., interest in closely-held company, LLC or other special asset such as real estate). Many times this also includes responsibility for directing the valuation of the directed assets. It might also be used where there is a desire to maintain a relationship with the grantor's broker or investment advisor who cannot or will not serve as Trustee.

#### 2. Distribution Decisions

An advisor is appointed to direct, consent to or disapprove a trustee's actions with respect to distributions, including making discretionary distribution decisions. This allows the grantor to select an individual who is close to the family or has personal knowledge of the beneficiaries and their needs. This can be very effective if any of the beneficiaries has special needs or if the grantor wishes to include provisions that require personal knowledge of the beneficiary's lifestyle, habits or challenges.

#### 3. Beneficiary Notification

If permitted by applicable governing law, an advisor can be appointed to determine how and when to provide notice and information to the beneficiaries. These are commonly referred to as "silent trusts."

#### 4. Tax Reporting

An advisor may be appointed to manage and direct all tax matters, including reporting and elections. This may be appropriate in those instances where the trust holds an operating business or an interest in a closely-held entity requiring special knowledge of the business and its tax issues.

#### 5. Change of Situs and Governing Law

An advisor may be appointed and granted authority to change the situs of the trust.[152] This decision can impact state income tax reporting, conflict of laws issues, and which state's courts have jurisdiction. The advisor may also be granted authority to change the applicable governing law.[153] The choice of law can impact the determination of the trust's validity, construction issues, the law governing administration of the trust and creditors rights.

#### 6. Amendment of Trust

An advisor may be appointed and granted the power to amend the trust. This power may be general or may specify or limit the advisor's amendment power.[154]

### C. <u>Grantor Direction</u>

The most common form of direction is that by a grantor while a trust is still revocable. The UTC provides in § 808(a) that "[w]hile a trust is revocable, the trustee may follow a direction of the settlor that is contrary to the terms of the trust." The comments to the UTC provide that § 808(a) is an application of UTC § 603(a) which provides that "a revocable trust is subject to the settlor's

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[152] The Trustee may have this power too, but might be reluctant to exercise it if there is any suggestion that the Trustee has a duty to monitor the "best" jurisdiction throughout the life of the trust.
[153] *Id.*
[154] *See* discussion *supra* at footnote 120, relating to the Trustee holding this power.

exclusive control as long as the settlor has capacity. Because of the settlor's degree of control, subsection (a) of this section authorizes a trustee to rely on a direction from the settlor even if contrary to its terms. The direction of the settlor might be regarded as an amendment of the trust."[155]

One way to make the grantor's direction clear is to specifically include the following sample language in the governing instrument:

> Notwithstanding the foregoing broad powers conferred upon the Trustee, there is hereby expressly reserved to the Grantor during the Grantor's lifetime and while the Grantor is legally competent, the right and power to direct the Trustee to take or to omit taking any action in regard to sales, investments, retention or any other matter relating to the administration of the Trust. Such power shall be deemed to be a personal power and not fiduciary in nature and may be exercised by written instrument delivered to said Trustee. Any and all things done or omitted to be done pursuant to such written directions shall be binding and conclusive on all parties in interest and said Trustee shall not be in any way liable or responsible to the Trust estate or to any beneficiary thereof for any loss or other consequences by reason of its compliance with such direction or by reason of failure to take any action in the absence of such direction.

By including this language in the instrument itself, the scrivener establishes the grantor's ability to direct separate from state law. It should be noted that this sample language is primarily geared towards investment decisions, and may need to be expanded if additional direction is anticipated and needs to be specifically addressed.

The following is sample language relating to a specific asset, real estate, held in the trust, and grantor's power to make all decisions and to assume full responsibility for such real estate while grantor is living and not incapacitated and until grantor shall otherwise direct the Trustee in writing. Note that the trustee is relieved from all responsibility and liability while grantor holds such powers. It would be possible to modify such language to appoint a third party to hold such powers on whatever terms the grantor intends.

> Grantor may transfer from time to time certain real property to this trust by Deed recorded with the appropriate Office of Recorder of Deeds. Notwithstanding any provision of this Agreement to the contrary, while Grantor is living and not incapacitated and until Grantor shall otherwise direct the Trustee in writing, Grantor shall have the right to use, possess and control such real property as Grantor shall determine, and the Trustee shall have no duty, accountability, responsibility or liability to Grantor or to any other person for any loss, damage, use of or financial obligation with respect to any such real property, including, without limitation, no right to collect any rent or other payments due in connection with such property (which rents and other payments, if any, shall continue to be payable to Grantor), nor shall the Trustee be responsible for any taxes thereon, nor shall the Trustee have any responsibility for keeping such property insured or for keeping the property in proper repair.[156]

## D. <u>Third Party Direction</u>

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[155] UTC § 808 Comment.
[156] *See* UMB A-14.

A grantor may also choose to appoint a third party to serve as advisor with directing powers over certain aspects of the trust's administration. This third party may be an individual, trusted advisor, family member, or even the beneficiaries themselves. The most common use of a third party advisor is to appoint an investment advisor. Some examples of when a third party advisor may be desired include the following situations:

1. The trust holds a family business and the grantor wishes to divide the trustee duties such that the corporate trustee will manage distributions and administrative matters and the third party advisor/family member will be responsible for investments.
2. The trust holds a concentration in a specialized asset requiring unique skill and management (e.g., private equity, alternative investments, concentrations of publicly traded stock, etc.) that the grantor wishes to maintain.
3. The grantor may also wish to put the distribution decisions into the hands of a trusted individual who may have a better understanding of his or her wishes. This may be especially useful where the governing instrument includes morality clauses on distributions and an individual would be in a better position to make such a determination.

The following is an example of language where control over the sale and retention of such assets are granted to a party other than the Trustee. This language appoints first the grantor, then the grantor's spouse, then a majority in interest of the adult beneficiaries and the guardians of incapacitated beneficiaries to make decisions regarding a specialized asset, closely-held stock, held in trust. The trustee is relieved from all decision making and liability regarding such stock. It would also be possible to modify this language to appoint a separate third party and to expand such language to encompass all investment responsibility or to address other types of investments than the sample provides. The trustee will be concerned that it is as fully relieved from liability as possible regardless of who is appointed. The Grantor should not retain control over investments in an irrevocable trust.

Anything herein to the contrary notwithstanding, in the event that [*my estate and*] the trust estate shall contain stock or securities of ___________________, a corporation [*Insert the appropriate references*], or any other entity or entities succeeding to the business of said corporation, by consolidation, merger, purchase of assets, or otherwise, [I] [*Grantor*] direct[s] that UMB Bank, n.a. shall have no authority over the sale or other disposition of said stock, and shall not vote or exercise the rights pertaining to all or any of said stock or securities of any kind or nature. [I] [*Grantor*] further direct[s] that any sale or other disposition of said stock and the exercise of voting or other rights pertaining to said stock shall be directed only by [*me*] [*Grantor*] while living and not incapacitated, and thereafter by [*my*] [*Grantor's*] spouse _______________ while living and not incapacitated, and thereafter by a majority in interest of the adult beneficiaries and the Guardians of incapacitated beneficiaries to whom income may then be payable or permitted to be paid hereunder, by prior written direction to [*my Personal Representative or*] the Trustee, as the case may be. UMB Bank, n.a. shall incur no liability for the sale, disposition, voting or other rights pertaining to said stock according to such written direction or the failure to take any action in the absence of a direction from those empowered to give such direction. It is [*my*] [*Grantor's*] intention to relieve UMB Bank, n.a., individually and as [*Personal Representative and*] Trustee, of every duty and responsibility concerning the management of said stock except where those empowered to give direction have executed a writing directing UMB Bank, n.a. as [*Personal Representative and*] Trustee to exercise investment authority with respect to such stock, including any duty UMB Bank, n.a. as [*Personal*

> *Representative and*] Trustee may have to apply to any court for instruction notwithstanding the fact that UMB Bank, n.a. as [*Personal Representative and*] Trustee has, or with reasonable inquiry should have, actual or constructive notice that any action taken or omitted pursuant to, or as a result of, the exercise of such directive authority constitutes, or may constitute, a breach of terms of this trust or a violation of any law applicable to the investment of the funds held hereunder.[157]

## E. Who is Responsible?

Determining who is "responsible" for the different aspects of administration will be based on both the terms and provisions of the governing instrument and the applicable governing law. The first question—is the advisor operating in a fiduciary capacity or not? The second question—is the directed trustee adequately relieved of its duties or not? If the trust instrument is not clearly drafted or if the jurisdiction selected doesn't have a strong directed trust statute, the directed trustee may be exposed to liability and the grantor's desired bifurcation of duties may not be effective.

As of 2017, there are 43 states with some form of a directed trust statute, with three different ideological approaches. These can be broadly categorized as (1) the Uniform Trust Code approach under UTC § 808, (2) the "Stronger Form" approach, and then finally (3) there are two states which have adopted statutes based on the Restatement (Second) of Trusts. Three states have multiple versions of applicable statutory language.[158] In addition, the Uniform Law Commission has recently approved the Uniform Directed Trust Act.[159]

### 1. The Original Directed Trust Statute—Delaware

Delaware has one of the most well-worn statutory schemes in the directed trustee context, adopting its statutes in 1986. Indeed, NCCUSL's Directed Trust Act Committee indicated the "popularity of directed trusts in Delaware."[160] Delaware's directed trust statute is an "enabling" statute (see below). It starts by establishing the fiduciary responsibility of an advisor with authority to "direct, consent to or disapprove a fiduciary's actual or proposed investment decisions, distribution decisions or other decision of the fiduciary."[161] It then proceeds to establish that, except in cases of willful misconduct on the part of the directed trustee, the fiduciary is not liable for following a direction from an advisor.[162] Note that NCCUSL's Directed Trust Act Committee was "influenced by the prominent directed trust

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[157] *See* UMB A-11.

[158] These three states are Florida, Indiana and Virginia. The portions of each state's statutes are referenced under the appropriate section below.

[159] *See* https://my.uniformlaws.org/committees/community-home?CommunityKey=ca4d8a5a-55d7-4c43-b494-5f8858885dd8. *See* Sherby, *"It's A Whole New Ballgame" Trust Directors, With Powers of Direction! But What About Trust Protectors* for an all states comparison chart for trust protector/advisor and directed trusts statutes.

[160] *See* Prefatory Note at https://www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=b468d31b-3bca-8344-ca7f-ebc2e2d8d9a2&forceDialog=0.

[161] 12 Del. C. § 3313(a).

[162] 12 Del. C. § 3313(b).

statute in Delaware" in preserving some minimal fiduciary duty in a directed trustee."[163] The Uniform Directed Trust Act follows Delaware's "willful misconduct" approach in determining liability for the directed trustee.[164]

The Delaware statute is entirely open-ended though, as to what powers may be given to an advisor, relying upon the drafting attorney to define and customize it to the grantor's needs. In addition, subsection (e) of the statute clarifies the bifurcation of trustee duties when such an arrangement is in place, stating that the trustee has no duty to monitor, advise the advisor or communicate or warn any beneficiary about differences of discretion.

The reason that Delaware's scheme is so established is the active Delaware judiciary and the responsive legislature working hand-in hand to provide predictability and substance to the Delaware trust landscape. Since the statute was enacted in 1986, the legislature has revisited the statute seven times.[165]

### 2. "Stronger Form" Statutes

Several states have enacted statutes that provide for stronger bifurcation of duties. These statutes are sometimes also referred to as "protective" statutes because they generally afford greater protection to a trustee relying on the direction of an advisor.[166] These "stronger" or "protective" statutes generally include the following features:

a. Advisor may direct any discretionary or ministerial function of trust administration;

b. A limited standard of directed trustee liability, such as no liability or only liable for "willful misconduct"; and

c. No trustee duty to monitor the decisions of the advisor or to identify breaches.[167]

There are 24 states that have adopted a stronger form of bifurcation in their statutes. These are: Alaska, **Arizona (2009)**, **Colorado (2014)**, Delaware, Georgia, Idaho, **Illinois (2015)**, Indiana, Kentucky, Michigan, **Minnesota (2016)**, **Missouri (2012)**, Nevada, New Hampshire, New Mexico, North Carolina, Ohio, Oklahoma, **South Dakota (1997)**, Tennessee, **Texas (2015)**, Utah, Washington, Wisconsin and Wyoming (UMB footprint states and dates of enactment are highlighted).[168]

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[163] *See* Prefatory Note at https://www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=b468d31b-3bca-8344-ca7f-ebc2e2d8d9a2&forceDialog=0.

[164] *Id.*

[165] 65 Laws 1986, ch. 422, § 5; 69 Laws 1994, ch. 279, § 1; 74 Laws 2003, ch. 82, § 3, eff. June 30, 2003; 76 Laws 2007, ch. 90, § 2, eff. Aug. 1, 2007; 76 Laws 2008, ch. 254, § 5, eff. Aug. 1, 2008; 78 Laws 2011, ch. 117, § 3, eff. Aug. 1, 2011; 79 Laws 2014, ch. 197, § 1, eff. Feb. 25, 2014; 80 Laws 2015, ch. 153, § 3, eff. Aug. 1, 2015.

[166] Fox and Abendroth, *Trustee Liability for Investments, A Review of the Current State of the Prudent Investor Rule, Delegation, and Direction* at 36–37.

[167] Wolven, Flubacher and Singer, *Do Not Feed After Midnight: Structuring and Drafting Trusts and Administration to Minimize Fiduciary Risk* at I-B-22.

[168] *See* A.S. 13.36.072(d), 13.36.375, ARS § 14-10808(B), CRS §§ 15-16-801–15-16-809, 12 Del. C. § 3313, Ga. Code Ann. §§ 53-12-500–53-12-506, Idaho Code § 15-7-501(2), (5), 760 ILCS 5/16.3(f)(1), Ky. Rev. Stat. Ann. § 286.3-275, Mich. Comp. Laws § 700.7703a, MSA § 501C.0808, RSMo § 456.8-808(8), Nev. Rev. St. § 163.5549,

Broadly, these can be categorized as either "off-the-rack statutes" or "enabling statutes."[169] The so-called "off-the-rack statutes" provide a detailed statutory rubric that provides a firm framework and sometimes requires strict compliance with the statutory language to fall within its protections.[170]

The so-called "enabling statutes" provide a more free-form design, which rely more heavily on the way the governing instrument is drafted and provide greater flexibility.[171]

The **Arizona** statute[172] provides that the trust instrument can include provisions stating that the assets of the trust are subject to the direction of the settlor, co-trustee, beneficiary or third party. It also provides that the trustee has no duty to review the directions received or to notify the beneficiaries regarding investment action taken pursuant to the direction. The trustee will not be responsible or subject to liability unless the trustee acts in bad faith or with reckless indifference. The statute also provides that a person who holds a power to direct is presumptively a fiduciary who will be liable for any loss that results from a breach of a fiduciary duty.

The **Colorado** statutes[173] include the concepts of an "excluded trustee" and a "trust advisor." A trust advisor is defined as a fiduciary. An excluded fiduciary will only be liable in cases of willful misconduct. The excluded fiduciary has no duty to monitor or review the actions of the trust advisor. The trust advisor must keep the excluded trustee reasonably informed, and the trust advisor submits to the jurisdiction of the courts of Colorado.

The **Missouri** statute[174] was revised in 2012 and again in 2018 to expand its protections beyond those offered by the UTC. As such, parts of the statute—for example, subsection 1—directly resemble the UTC § 808 language, while other parts offer significant expansions. The provisions primarily focus around the term "trust protector," and the powers in subsection 3 track those typically associated with trust protectors, however, paragraph 6 in subsection 3 states that the trust protector may be granted "such other powers as are expressly granted to the trust protector in the trust instrument."[175] Moreover, subsection 7 changes the level of duties the trust protector assumes:

> If a trust protector is granted a power in the trust instrument to direct, consent to, or disapprove a trustee's actual or proposed investment decision, distribution decision, or other decision of the trustee required to be performed under applicable trust law in carrying out the duties of the trustee in administering this trust, then only with respect to such power,

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N.M. Stat. Ann. §§ 46-14-1–46-14-18, N.H. Rev. Stat. Ann. § 564-B:8-808(b), N.C. Gen. Stat. §§ 36C-7-703(e1)(1), 32-72(d)(2)(a), 36C-8A-4(a), Ohio Rev. Code Ann. §§ 5808.08(B), 5815.25(B), Okla. Stat. Ann. Tit. 60, § 175.19,SDCL §§ 55-1B-2(1), 55-1B-5, Tenn. Code. Ann. §§ 35-15-808(b), (e), 35-3-122, Utah Code Ann. § 75-7-906(4), RCW 11.98A.010-900, W.S.A. 701.0808 and Wyo. Stat. §§ 4-10-808(b), 4-10-715, 4-10-717, 4-10-718.

[169] Wolven, Flubacher and Singer, *Do Not Feed After Midnight: Structuring and Drafting Trusts and Administration to Minimize Fiduciary Risk* at I-B-24.

[170] *Id.*

[171] *Id.*

[172] ARS § 14-10808.

[173] CRS §§ 15-16-801–15-16-809.

[174] RSMo § 456.8-808.

[175] RSMo § 456.8-808.3(6).

excluding the powers identified in subsection 3 of this section, the trust protector shall have the same duties and liabilities as if serving as a trustee under the trust instrument.[176]

The trust protector shall act in a fiduciary capacity unless the governing instrument provides otherwise,[177] and the trustee shall only be liable for carrying out the trust protector's written directions as provided in the trust instrument."[178] The trustee has no duty to monitor or advise the trust protector. The trust protector also submits to the jurisdiction of the courts of Missouri.[179]

The **Illinois** and **Minnesota** statutes[180] are good examples of an "off-the-rack statute." These statutes define specific concepts such as "excluded fiduciary," "distribution trust advisor," "investment trust advisor" and "trust protector." They also clearly lay out the roles of each (unless defined in the governing instrument otherwise).[181] In addition, these statutes provide strong statutory defaults, such as the default that a directing party is "a fiduciary of the trust subject to the same duties and standards applicable to a trustee of a trust as provided by applicable law unless the governing instrument provides otherwise."[182] The "excluded fiduciary" generally has no duty to "monitor, review, inquire, investigate, recommend, evaluate, or warn with respect to a directing party's exercise or failure to exercise any power granted to the directing party in the governing instrument, including but not limited to any power related to the acquisition, disposition, retention, management, or valuation of any asset or investment."[183] An excluded fiduciary will only be liable in cases of "willful misconduct." The advisor must keep the "excluded fiduciary" reasonably informed, and the advisor submits to the jurisdiction of the courts.

The **South Dakota** statute[184] is a good example of an "enabling" statutory scheme—in this case, an entire chapter, SDCL § 55-1B, is devoted to directed trusts. Its statutes are framed in much more permissive terms—stating the kinds of provisions that a governing instrument *may* provide. It includes the concepts of a "trust protector," "trust advisor," "excluded fiduciary," "investment trust advisor," "distribution trust advisor," and "family advisor." It affirmatively provides that an excluded fiduciary is not liable in a litany of different circumstances, including losses from complying with direction from a directing party (including direction that constitutes a breach of a trust advisor's fiduciary duties) and any affirmative duty to review or evaluate directions on distributions or to undertake any investment reviews.[185] An excluded fiduciary will only be liable in cases of "gross

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[176] RSMo § 456.8-808.7.
[177] *See supra* for discussion of Missouri's recent change as to the standard of care.
[178] RSMo § 456.8-808.8.
[179] *See supra* for discussion of the recent changes to Missouri's statute. As discussed above, the changes are designed to clarify that a trust instrument which names, appoints, authorizes or otherwise designates a trust protector shall be deemed a directed trust, which has strengthened Missouri's statute. Again, the use of the terminology of trust protector does create some confusion.
[180] 760 ILCS 5/16.3(b) and MSA § 501C.0808.
[181] *See e.g.,* 760 ILCS 5/16.3(b).
[182] 760 ILCS 5/16.3(e).
[183] 760 ILCS 5/16.3(f).
[184] SDCL §§ 55-1B-1–55-1B-12.
[185] SDCL § 55-1B-2.

negligence or willful misconduct." A trust protector or advisor is considered a fiduciary and is subject to the same standards of liability applicable to a trustee. In addition, it raises the standard of proof for breach of duty to clear and convincing evidence.[186] In general, it provides various lists of powers and discretions of trust protectors, investment trust advisors and distribution trust advisors.[187] The trustee has no duty to review or evaluate a direction received or to monitor the actions taken within the scope of the advisor's authority. The South Dakota statutes also provide that by accepting an appointment to serve as a trust advisor or trust protector, they submit to the jurisdiction of the courts of South Dakota.

The **Texas** statute[188] was adopted in 2015 and includes the concepts of an "advisor" and a "protector." It provides for fiduciary treatment of any person who, under the terms of the trust, has the authority to direct, consent to, or disapprove of a trustee's decisions.[189] This falls within the category of "enabling" statutory schemes, providing a general rule, and not circumscribing specific powers or requirements. In addition, Texas provides that if the governing instrument provides that a trustee must act in accordance with direction, then the trustee has no duty to monitor, advise or consult with the directing advisor, or to warn any beneficiary.[190] Overall, the trustee is subject only to the standard of willful misconduct for actions taken according to advisors direction and willful misconduct or gross negligence for decisions subject to an advisor's consent.[191] While the Texas statute contains many of the elements of a stronger form statute, it permits the scrivener to draft around some of the most important elements. Additionally, the statute does not specifically subject the advisor or protector to the jurisdiction of the court. So, the terms and provisions of the governing instrument will need to be carefully drafted to ensure clear bifurcation of duties.

It is important to note that, even though the statutes in these states include stronger bifurcation of duties, like that seen in the Delaware statute, they may not have the active judiciary and the responsive legislature to provide the same level of predictability and substance as that provided in Delaware, at least at present.

### 3. UTC States

There are 15 states, and the District of Columbia, with directed trust statutes based on the Uniform Trust Code. These are: Alabama, Arkansas, the District of Columbia, **Kansas (2002)**, Maine, Maryland, Massachusetts, Mississippi, Montana, **Nebraska (2003)**, North Dakota, Oregon, Pennsylvania, South Carolina, Vermont, and West Virginia (UMB footprint states and dates of enactment are highlighted).[192]

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[186] *Id.*
[187] SDCL §§ 55-1B-6, 55-1B-10 and 55-1B-11.
[188] Tex. Prop. Code § 114.0031. *See also,* Tex. Prop. Code § 114.003 for statute concerning powers to direct with respect to charitable trusts.
[189] Tex. Prop. Code § 114.0031(e).
[190] Tex. Prop. Code § 114.0031(h).
[191] Tex. Prop. Code § 114.0031(f), (g).
[192] *See* A.S. 13.36.072(d), 13.36.375, Ala. Code § 19-3B-808(b), Ark. Code Ann. § 28-73-808(b), D.C. Code Ann. § 19-1308.08(b), KSA § 58a-808(b), Me. Rev. Stat. Ann. Tit. 18-B, § 808(2), MD Code, Estates and Trusts, § 14.5-808, Mass. Gen. L. ch. 203E, § 808(b), Miss. Code Ann. § 91-8-808, MCA § 72-38-808, Neb. Rev. St. § 30-3873(b), N.D. Cent. Code § 59-16.2-06, Or. Rev. Stat. § 130.685(2), 20 Pa. Cons. Stat. § 7778(b), S.C. Code Ann.

Section 808(b) of the UTC provides:

> If the terms of a trust confer upon a person other than the settlor of a revocable trust power to direct certain actions of the trustee, the trustee shall act in accordance with an exercise of the power unless the attempted exercise is manifestly contrary to the terms of the trust or the trustee knows the attempted exercise would constitute a serious breach of a fiduciary duty that the person holding the power owes to the beneficiaries of the trust.

Under § 808(b), the trustee continues to possess liability for deciding whether to follow direction, as it must evaluate whether the exercise would consist of a breach of fiduciary duty. In addition, while the direction language may provide some greater protection for the Trustee, it does subject the third party to potential liability. The UTC provides that a person, other than a beneficiary, who holds a power to direct is presumed to be a fiduciary and is required to act in good faith with regard to the purposes of the trust and the interests of the beneficiary and the holder is liable for any loss that results from a breach of this fiduciary duty.[193] Thus, the UTC language does not adequately bifurcate the responsibilities of the Trustee.[194] Note that the drafters of the UTC believed that subsections (b)–(d) "ratify the use of trust protectors and advisors."[195]

As indicated above, two of UMB's footprint states have statutes that follow the UTC approach. The Kansas and Nebraska statutes[196] mirror the UTC provision.

**4. Restatement (Second) States**

One state, Iowa, has a directed trust statute based on Section 185 of the Restatement (Second) of Trusts.[197] Section 185 of the Restatement (Second) provides:

> If under the terms of the trust a person has power to control the action of the trustee in certain respects, the trustee is under a duty to act in accordance with the exercise of such power, unless the attempted exercise of the power violates the terms of the trust or is a violation of a fiduciary duty to which such person is subject in the exercise of the power.

This last phrase insufficiently protects a trustee from following the direction, as it is still subject to making a determination of whether any given action is in violation of its fiduciary duty. As such, the bifurcation permitted in this jurisdiction will be incomplete. The Iowa statute[198] mirrors the Restatement (Second) provision shown above.

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§ 62-7-808(b), Tex. Prop. Code Ann. § 114.003(b), Vt. Stat. Ann. Tit. 14A, § 808(b), and W. Va. Code § 44D-8-808(b).

[193] UTC § 808(d) and Comment to § 808.

[194] Of course, the states which have enacted the UTC may have varied from the UTC's language, so specific state law must be consulted. *See* KSA § 58a-808(b); Neb. Rev. St. § 30-3873(b); ARS § 14-10808(B). *See also* Tex. Prop. Code. § 114.003(b); 760 ILCS 5/16.3(f)(1); and ICA § 633A.4207(2) for examples in non-UTC states.

[195] UTC § 808 Comment.

[196] KSA § 58a-808 and Neb. Rev. St. § 30-3873.

[197] *See* ICA § 633A.4207(2). Iowa enacted these provisions in 1999.

[198] ICA § 633A.4207.

### 5. Blended Approach

Three states, Florida, Indiana and Virginia, have adopted a blended approach in their directed trust statutes.[199]

The Florida and Virginia statutes are basically UTC statutes with some optional provisions. The Florida statute includes an additional provision enabling the terms of the governing instrument to divide the trustee duties and responsibilities between more than one trustee and protect the excluded trustee from liability.[200] The Virginia statute enables the grantor to incorporate subsection E into the trust instrument (or add it to an existing trust instrument by including in a nonjudicial settlement agreement) and create a directed trust with the same protections afforded by most "enabling" statutes.[201]

The Indiana statute is basically a Restatement (Second) statute with an addition provision enabling the scrivener to include terms that both (a) expressly direct the trustee to rely on direction of a third party, and (b) expressly relieve the trustee from liability if he or she does so.[202]

While these optional provisions in the Florida, Indiana and Virginia statutes lead some commentators to classify them as "stronger form" statutes, the protection afforded by these statutes depends entirely on the work of the scrivener and the terms of the governing instrument.

### 6. No Directed Trust Statute

Finally, the seven states that have no directed trust statute as of the date of this outline are: California, Connecticut, Hawaii, Louisiana, New Jersey, New York and Rhode Island.

### 7. The Uniform Directed Trust Act

The Uniform Directed Trust Act ("Uniform Act") was approved and recommended by the National Conference of Commissioners on Uniform State Laws ("NCCUSL") for enactment in all states at its July 2017 meeting after an approximately two year study and drafting period by the Directed Trust Act Committee.[203] The final Uniform Act was posted in November 2017.[204]

The Uniform Act provides for an "enabling" statutory scheme. The drafters of the Uniform Act recognized that "[t]here is much uncertainty in existing law about the fiduciary status of a nontrustee that has a power over a trust and about the fiduciary responsibility of a trustee (sometimes called an "administrative trustee" or "directed trustee") with regard to actions taken or directed by the nontrustee" as well as the inconsistencies in vocabulary describing

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[199] *See* Fla. Stat. § 736.0808, Ind. Code Ann. § 30-4-3-9 and Va. Code Ann. § 64.2-770.
[200] *See* Fla. Stat. § 736.0808(9).
[201] *See* Va. Code Ann. § 64.2-770(E).
[202] Ind. Code Ann. § 30-4-3-9(a).
[203] *See* https://my.uniformlaws.org/committees/community-home?CommunityKey=ca4d8a5a-55d7-4c43-b494-5f8858885dd8for interesting materials regarding the ULC Committee's research, history and process in its drafting of the Uniform Act. A copy of the Uniform Act may also be found there.
[204] https://my.uniformlaws.org/committees/community-home?CommunityKey=ca4d8a5a-55d7-4c43-b494-5f8858885dd8.

"the nontrustee powerholder in a directed trust. Several terms are common in practice, including 'trust protector,' 'trust advisor,' and 'trust director.'"[205] The Uniform Act's Prefatory Note goes on to say that "[e]xisting uniform trusts and estates acts address the issue inadequately. Existing nonuniform state laws are in disarray."[206]

The Uniform Act contains twenty sections. The Uniform Act's Prefatory Note discusses the structure of the Act and states that "The heart of the Uniform Directed Trust Act appears in Sections 6 through 11, which address the powers and duties of a trust director and a directed trustee. Sections 6 through 8 address the kinds of powers that the terms of a trust can grant to a trust director and the default and mandatory fiduciary duties of the director. Sections 9 through 11 address the fiduciary duty of a directed trustee and prescribe the ways in which a power of direction in a trust director changes the trustee's powers and duties. Section 12 addresses cotrusteeship, enabling the settlor to apply the fiduciary standards of conduct for a directed trust under this act to a cotrusteeship."[207] The Uniform Act also includes typical uniform act provisions such as a short title, definitions, application and principal place of administration, law and principles of equity, uniformity of application and construction, relation to electronic signatures in Global and National Commerce Act, repeals; conforming amendments and effective date.

As with most uniform acts, the definitions section is crucial and the Uniform Act is no exception. Section 2 contains a variety of definitions, including those for "directed trust," "directed trustee," "power of direction" and "trust director."[208] There are also other definitions found in other related acts, such as "settlor," "state," "terms of a trust," and "trustee."[209] The Uniform Act contains several legislative notes to aid states in their review and adoption of the Uniform Act and cross references to the UTC and the Uniform Decanting Act. As with all uniform acts, the purpose of the Uniform Act is to bring uniformity to the law for the states which adopt it.[210]

The drafters further state in their Prefatory Note: "Under the Uniform Directed Trust Act, a power over a trust held by a nontrustee is called a 'power of direction.' The holder of a power of direction is called a 'trust director.' A trustee that is subject to a power of direction is called a 'directed trustee.' The main contribution of the act is to address the many complications created by giving a power of direction to a trust director, including the

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[205] *See* Uniform Act's Prefatory Note found at https://www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=b468d31b-3bca-8344-ca7f-ebc2e2d8d9a2&forceDialog=0.

[206] *Id.*

[207] *Id.*

[208] Uniform Act § 2 found at https://www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=b468d31b-3bca-8344-ca7f-ebc2e2d8d9a2&forceDialog=0.

[209] *Id.*

[210] Uniform Act § 17—"In applying and construing this uniform act, consideration must be given to the need to promote uniformity of the law with respect to its subject matter among states that enact it."

fiduciary duty of a trust director and the fiduciary duty of a directed trustee."[211] The Uniform Act expressly recognizes the grantor's ability to adopt a directed trustee scheme and imposes a mandatory minimum fiduciary duty upon both the trust director and the trustee "director in accordance with the traditional principle that a trust is a fiduciary relationship."[212]

The Prefatory Note continues: "Under the Uniform Directed Trust Act, a trust director has the same default and mandatory fiduciary duties with respect to a power of direction that would apply to a trustee if a trustee held the same powers (Section 8), and a directed trustee is liable only for the trustee's own 'willful misconduct' in complying with a trust director's exercise or nonexercise of a power of direction (Section 9). Regarding a power of direction, the trust director functions much like a trustee in an undirected trust and thus should have the same duties as a trustee in the exercise or nonexercise of the director's power of direction. To facilitate the settlor's intent that the trust director be the primary or even sole decision-maker regarding a power of direction, the fiduciary duty of the directed trustee is reduced with respect to issues over which the director holds the power of direction. In preserving some minimal fiduciary duty in a directed trustee, the drafting committee was influenced by the prominent directed trust statute in Delaware, which provides likewise. See 14 Del. Code Ann. tit. 12, § 3313 (2017). The popularity of directed trusts in Delaware establishes that a directed trust statute that preserves in a directed trustee a duty to avoid "willful misconduct" is workable in directed trust practice. *The drafting committee therefore declined the suggestion that the Uniform Directed Trust Act should eliminate completely the fiduciary duty of a directed trustee.* In summary, under the Uniform Directed Trust Act a beneficiary's main recourse for misconduct by a trust director is an action against the director for breach of the director's fiduciary duty to the beneficiary. The beneficiary also has recourse against the directed trustee, but only to the extent of the trustee's own willful misconduct. Compared with a non-directed trust, the act increases the total fiduciary duties owed to a beneficiary. All of the usual duties of trusteeship are preserved in the trust director, and in addition the directed trustee has a duty to avoid willful misconduct." (emphasis added)[213]

To date, Georgia, Michigan and New Mexico have adopted the Uniform Act, and it has been introduced in Colorado and Nebraska.

### F. **Potential Impact on Trustee Fees**

It is possible that the fees charged by a directed trustee may be lower than those of a trustee responsible for every aspect of the trust's administration. For example, a directed trustee with no investment responsibility may be willing to lower its standard fees to reflect that the trustee has less responsibility and risk. Of course, the impact on the fees will vary depending on the duties and responsibilities assigned to the directing party, the duties retained by the trustee, the protection from liability afforded the trustee by the terms of the governing instrument and applicable law, and the other circumstances of the bifurcation of duties.

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[211] Prefatory Note found at https://www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=b468d31b-3bca-8344-ca7f-ebc2e2d8d9a2&forceDialog=0.
[212] *Id.* The Note cites Restatement (Third) of Trusts § 96 cmt. c (2012).
[213] *Id.*

## G. <u>Drafting for Directed Trusts</u>

A well drafted trust instrument is an essential first step to creating a directed trust. If the trust instrument is not properly drafted or if there are any ambiguities concerning the bifurcation of duties, the directed trustee could be exposed to liability and the efficient administration of the trust could be frustrated.

### 1. "Direction" Language

The advisor should be given the authority to direct the trustee as to the specific powers held by the third party director rather than the authority to consent to or disapprove decisions of the trustee.

### 2. Trustee Action "Solely" at Direction

The direction provision should specify that that trustee must act solely or exclusively in accordance with the written direction of the advisor.

### 3. Trustee Retains Trust Power and Authority

The direction provision should not shift too much power and authority to the advisor. The trustee must have the power and authority to take action as directed by the advisor. Avoid provisions that state the "trustee shall have no trust power and authority."

### 4. No Duty to Monitor

The trust instrument should specify that the trustee has no duty to monitor, advise, warn or otherwise interfere with the decisions of the advisor.

### 5. Directed Trustee Liability

The direction provision should clearly provide that the directed trustee is only liable for "willful misconduct" to ensure that the trustee can follow the direction of the advisor without monitoring or reviewing the direction of the advisor.

### 6. Require Written Direction

The trust instrument should require that all directions from the advisor be delivered to the trustee in writing.

### 7. Unique or Special Assets provision

If the trust holds any unique or special assets, it is important to include specific language addressing the management, valuation and risk associated with holding these assets.

### 8. Comprehensive Advisor Provisions

The trust **instrument** should also include provisions that address what happens when there is no advisor serving, compensation of the advisor, and a succession plan for advisor role.

### 9. Reference Applicable State Law

Consider adding specific statutory references under which the directed trust is created.

## H. Sample Provisions

### 1. Establishing an Investment Advisor/Directed Trustee.

The following provisions, provided by Todd Flubacher of Morris, Nichols, Arsht & Tunnell LLP, illustrate an example of how to provide for the appointment of an investment advisor.

ARTICLE ______: INVESTMENT ADVISOR

**1.1 Initial Investment Advisor**. The initial investment advisor ("Investment Advisor") of each trust hereunder shall be ________________.

**1.2 Successor Investment Advisors**. If at any time during the continuance of any trust hereunder there shall be no Investment Advisor of such trust, the Trust Protector may, but need not, appoint a successor Investment Advisor. To qualify, any person designated as Investment Advisor of a trust hereunder shall deliver a written instrument to the Trustee indicating acceptance and agreement that all powers conferred upon such Investment Advisor will be exercised in a fiduciary capacity for the exclusive interest of the beneficiaries.

**1.3 Investment Direction**. Notwithstanding any other provision of this Agreement, whenever an Investment Advisor is serving, the Trustee shall exercise all Investment Powers (as defined in the following Section (Investment Powers)) with respect to all assets held as part of the trust estate [alternatively, this could be limited to "Special Holdings"] only upon the written direction of the Investment Advisor; provided, however, that the Grantor, when acting as an Investment Advisor hereunder, shall have no power to direct the Trustee with respect to life insurance on the life of the Grantor or any Incidents of Ownership associated therewith and no power to vote any interest in a controlled corporation within the meaning of Code Section 2036(b) of the Code. If the Grantor is serving as Investment Advisor and the trust holds or will acquire life insurance on the life of the Grantor, or the trust holds or will acquire any interest in a controlled corporation within the meaning of Code Section 2036(b) of the Code, then the Grantor shall appoint a separate Investment Advisor, and may remove and appoint any such separate Investment Advisor, to possess all of the powers of the Investment Advisor hereunder with respect to such life insurance or controlled corporation; provided, however, that the Grantor may not appoint any person who is related or subordinate to the Grantor within the meaning of Section 672(c) of the Code as such Investment Advisor.

**1.4 Investment Powers**. For all purposes of this Agreement, "Investment Powers" shall mean and include:

(1) investment powers granted to the Trustee under Subsections (2) through (5), (7) through (14) (other than the power to decline to accept property into trust with respect to property that has or may have environmental liability attached) and (19) (other than loans which are not made solely for investment purposes under subsections (19)(b) and (c)) of Section 3325 of Title 12 of the Delaware Code or any successor provision thereto;

(2) all powers granted to the Trustee in subparagraphs _____________;

(3) the powers to appoint, employ and remove, at any time and from time to time, the following agents and service providers and to delegate to such agents any of the discretionary and nondiscretionary powers granted to the Trustee: (i) a qualified manager or administrator for all or any part of the assets of the trust; (ii) investment advisors, managers, counselors, brokers and other investment experts; (iii) custodial agents having the authority to hold the investments of the trust for and on behalf of

the trust; (iv) real property, business, and other kinds of appraisers; and (v) environmental experts with regard to the investment or ownership of trust property;

(4) all powers described as an "investment decision" in Section 3313(d) of Title 12 of the Delaware Code; and

(5) all other powers relating to the acquisition, disposition, retention, exchange, change in character, lending, borrowing, pledging, mortgaging, managing, voting, leasing, granting of options with respect to, insuring, abandoning, or in any other way relating to the investment or management of the trust estate.

**1.5 Trustee Has No Duty To Monitor**. Whenever an Investment Advisor is serving, the Trustee shall have no responsibility to undertake any review of, or to provide advice regarding, any part of the trust estate subject to the direction of the Investment Advisor. Whenever an Investment Advisor is serving, the Trustee shall have no duty or obligation to (a) communicate with or warn any beneficiary or any third party concerning instances in which the Trustee would or might have exercised the Trustee's discretion in a manner different than the manner exercised by the Investment Advisor, (b) inquire into or monitor the directions of the Investment Advisor notwithstanding any appearance of or actual conflict of interest of the Investment Advisor, or (c) inquire into, monitor or question the prudence of or inform any beneficiary with respect to the investment of the trust estate subject to the direction of the Investment Advisor, and any and all review of the investments by the Trustee shall be presumed to be solely for statement, tax reporting and/or other administrative purposes. The Trustee shall have no duty to seek the direction of the Investment Advisor in the absence of any direction. The Trustee shall be entitled to the full protection of Section 3313(e) of Title 12 of the Delaware Code without limitation. The Grantor has included the provisions of this Article in order to effectively bifurcate the investment function from other functions of the Trustee in order for investment decisions to be made by the Investment Advisor without the interference of the Trustee. Furthermore, in accordance with Sections 3302(e) and 3586 of Title 12 of the Delaware Code, the Trustee shall have no liability under this Agreement to any trust beneficiary or any other person whose interest arises under this Agreement for the Trustee's good faith reliance on this Section or any other provision of this Agreement (unless the Trustee has acted with willful misconduct).

**1.6 Execution of Documents**. The Trustee shall execute all documents necessary or appropriate in connection with any matter that is the subject of directions from the Investment Advisor, including, without limitation, making any representation, warranty or covenant required in order to make or maintain any investment of the trust and any future action with respect to any such representation, warranty or covenant, only as directed by the Investment Advisor. The Trustee shall have no duty to conduct an independent review of documents presented to it by the Investment Advisor in furtherance of the Investment Advisor's written instruction to the Trustee and shall sign the same as presented. Further, the Investment Advisor shall have the authority to direct the Trustee with regard to amending, securing, paying, and otherwise dealing with any debts, promissory notes, and other obligations of the trust. Whenever an Investment Advisor is serving, the Trustee shall act solely at the direction of the Investment Advisor in executing and delivering any and all documents, such as purchase and sale agreements, necessary or convenient to, or otherwise prepared in connection with, the purchase, sale, exchange, transfer, pledge or other disposition or encumbrance of trust investments and in making any and all representations and warranties appearing in any such documents.

**1.7 Providing Information**. The Investment Advisor shall, upon written request of any other fiduciary serving hereunder, provide such fiduciary with information necessary for such fiduciary to fulfill its fiduciary duties, including, without limitation, all information necessary to value any asset

subject to the direction of the Investment Advisor. Without limitation of the foregoing, the Investment Advisor shall provide the Trustee with a valuation of all Special Holdings held under this agreement within a reasonable period of time following the end of each calendar year.

**1.8 Special Holdings**. For purposes of this Agreement, the term "Special Holdings" shall include (i) shares of common capital stock (voting or non-voting), preferred stock, membership interests in limited liability companies, interests in limited partnerships and other interests in closely held businesses not actively traded on an established public market; (ii) real estate; (iii) any property received with respect to, or in exchange for, property described in clause (i) above; and (iv) property identified in writing as Special Holdings by the Investment Advisor. Whenever an Investment Advisor is serving, the Trustee shall value Special Holdings and any other assets of the trust not actively traded on a public exchange only as directed by the Investment Advisor. Additionally, whenever an Investment Advisor is serving, the Trustee shall manage or participate in the management of Special Holdings, to the extent the governing instruments or applicable law require the trust to manage the same, only as directed by the Investment Advisor. Finally, whenever an Investment Advisor is serving, the Trustee will not be responsible for the investment performance of any Special Holdings, and shall not take Special Holdings into consideration in the investment management of the other trust assets.

**1.9 Investment Agency Contracts**. Whenever the Investment Advisor desires to exercise its powers, pursuant to this Agreement, to appoint, employ or remove investment advisors, investment managers, investment counselors, or other investment providers or investment experts, or to direct the Trustee to exercise its powers to employ such agents, the Investment Advisor may either do so directly (with written notice to the Trustee) or may direct the Trustee to appoint, employ or remove such agents.

**1.10 Absence of Investment Advisor**. At all times during which no successor Investment Advisor has been appointed and is serving for a trust hereunder, the Trustee acting alone shall exercise all of the powers theretofore exercised upon the written direction of the Investment Advisor. At any time or times when the Trustee is exercising the powers theretofore exercised upon the direction of the Investment Advisor, the Trustee shall be under no duty to examine the actions of any Investment Advisor that served theretofore or to inquire into the acts or omissions of any such Investment Advisor and shall not be liable for any act or omission of any such Investment Advisor and shall not be liable for any failure to seek redress for any act or omission of any such Investment Advisor. At any time or times when the Trustee is exercising the powers theretofore exercised upon the direction of the Investment Advisor, the Trustee may sell, transfer, exchange, convert or otherwise dispose of, any property held as part of the trust estate, at public or private sale, with or without security, and without regard to tax implications, in such manner, at such time or times, for such purposes, for such prices and upon such terms, credits and conditions as the Trustee, in its sole and absolute discretion, may deem advisable. The Trustee may also, in its sole and absolute discretion, retain any such property for any period, whether or not the same be speculative or be of the character or proportion permissible for investments by fiduciaries under any applicable law, without regard to any effect the retention may have upon the diversification of the investments, and without regard to liquidity of, or any change in the value of any particular investment. The Trustee shall be under no duty to sell or otherwise dispose of any particular investment merely because of the amount or value of such investment or type of investment in relation to the total amount or value of the trust estate. It is the Grantor's intent that if the Trustee becomes responsible for the investment of the trust estate following a vacancy in the position of Investment Advisor, that the Trustee shall have a reasonable opportunity to modify the investment composition of the trust estate in accordance with its own discretion, and accordingly, notwithstanding any other provision of this Agreement, the

Trustee shall not be liable hereunder for any investment decision made for a reasonable period of time following a vacancy in the position of Investment Advisor absent such Trustee's own willful misconduct.

**1.11 Investment Advisor Compensation**. Each Investment Advisor's compensation (if any) may be designated and thereafter changed from time to time with respect to each such trust by the Trust Protector. In addition the Investment Advisor may be reimbursed for out-of-pocket expenses, including investment counsel fees incurred on behalf of such trust.

**1.12 No Duty to Monitor Other Fiduciaries**. The Investment Advisor shall have no duty to monitor the conduct of the Trustee.

**1.13 Investment Advisor Liability**. The Investment Advisor shall serve in a fiduciary capacity and shall be liable hereunder only for the Investment Advisor's willful misconduct and gross negligence.

**1.14 Investment Advisor Indemnification**. Each Investment Advisor shall be indemnified and held harmless by the trust created hereunder which such Investment Advisor serves or served against any threatened, pending or completed action, claim, demand, suit or proceeding, whether civil, criminal, administrative or investigative, falling within the exculpatory provisions of the preceding Section (Investment Advisor Liability) or to which the Investment Advisor is made a party, or threatened to be made a party, by reason of serving as Investment Advisor if the Investment Advisor acted in accordance with the standards of liability set forth herein. Such indemnification shall include expenses, including attorneys' fees, judgments, fines and amounts paid in settlement actually incurred by the Investment Advisor in connection with such action, claim, demand, suit or proceeding. The cost of indemnification may be paid in advance of the conclusion of the matter involved.

**1.15 Resignation and Removal of Investment Advisor**. Each Investment Advisor may resign at any time, upon thirty (30) days written notice to the Trust Protector and the Trustee. The Trust Protector may remove any Investment Advisor from office at any time, and for any reason, with or without cause, and may, but need not, appoint a successor Investment Advisor.

**1.16 Multiple Investment Advisors**. Except as otherwise provided herein, if more than two (2) co-Investment Advisors are acting as to any trust hereunder they shall act by majority vote of the Investment Advisors. Notwithstanding the foregoing, if more than one person is serving in the office of Investment Advisor, the co-Investment Advisors may designate, by written instrument executed by all co-Investment Advisors serving in such office, one co-Investment Advisor to convey all written directions and notifications to the Trustee. A copy of such designation instrument shall be provided to the Trustee for its records. Until otherwise advised in writing by all co-Investment Advisors serving, the Trustee shall be entitled to rely on the designation set forth in such designation instrument.

**1.17 Written Directions**. Any written direction to the Trustee from the Investment Advisor or any other person authorized by the terms of this Agreement to direct the Trustee in the exercise of the Trustee's powers as to any particular matter, shall be in writing in such form as shall be acceptable to the Trustee. If so approved by the Trustee, such written directions may be in an electronic form such as an electronic mail message ("e-mail") from an e-mail address on file with the Trustee or a digital file bearing an electronic signature or a copy of a signature. Delivery of such written instructions may be by mail, courier, facsimile transmission, e-mail, or otherwise in such manner as is acceptable to the Trustee and to such address, facsimile number or e-mail address as the Trustee may specify from time to time to the person directing the Trustee. If the Trustee is directed by the Investment Advisor to execute a document that contains any representation or warranty, or with respect to which the Trustee or the trust must satisfy any requirement or condition such as, for example but without limitation, any requirement that the

Trustee or the trust be an accredited investor, the Trustee may require the Investment Advisor to include a statement in the written direction letter that the Investment Advisor: (1) agrees to the representations, warranties and covenants in such document, (2) makes the Investment Advisor's own representation and warranty that that the representations and warranties in such document are true and correct, and (3) acknowledges any requirements or conditions for entering into the transaction and confirms that the Trustee and the trust satisfy such requirements and conditions. The Trustee shall have the right to require the Investment Advisor to make revisions to any written direction if such direction is, in the sole discretion of the Trustee, inadequate due to vagueness, lack of specificity, because the direction confers discretion upon the Trustee, to satisfy the requirements of the Trustee described hereinbefore relating to representations, warranties, covenants or other requirements or conditions, or a failure for any other reason to provide complete directions to enable the Trustee to carry out such direction as a purely executory action, and the Investment Advisor shall have the obligation to make any such revisions. The trustee may reject any written direction letter if the Trustee determines, in its sole discretion, that it does not have the requisite trust power and authority to execute any part of the direction or if the Trustee is otherwise restricted from executing the direction applicable contract provisions or entity governance documents, applicable law, or a Court order. The Trustee shall have no liability absent its own willful misconduct for any matter arising in connection with requiring revisions to any direction letter or rejecting any direction letter for reasons described in this Section and the Trustee may rely without further inquiry upon any representations or warranties, or confirmation of the satisfaction of any requirements or condition, in any direction letter and shall have no liability hereunder in doing so except in cases of its own willful misconduct.

**1.18 Special Standard of Liability**. Notwithstanding the foregoing, whenever, pursuant to the terms of this Agreement, the Trustee acts at the direction of the Investment Advisor or any other person authorized by the terms of this Agreement to direct the Trustee in the exercise of the Trustee's powers as to any particular matter, as provided in Section 3313(b) of Title 12 of the Delaware Code, the Trustee shall have no liability with respect to such matter except in cases of the Trustee's own willful misconduct.

**2. Establishing an "Administrative Trustee" Under South Dakota Law.**

The following provision might be used to appoint an administrative trustee under South Dakota law where a registered investment advisor will manage the trust's investments. Note the use of the "excluded fiduciary" under South Dakota law.

ARTICLE ______________: Notwithstanding any provision of this Trust Agreement to the contrary, during such time as the Advisor (as defined below) or such other investment manager is serving, the Trustee shall administer the investments of this Trust Agreement in accordance with the directions of **[Registered Investment Advisor]** and its successors by merger, consolidation or otherwise ("Advisor") or in accordance with the directions of such other investment manager as may be designated from time to time in writing as provided for herein, sign such Investment Management Agreement as Advisor or such other investment manager shall from time to time direct, open such securities accounts with such brokerage houses and in such form as Advisor or such other investment manager shall from time to time direct, sign such trading authorizations as Advisor or such other investment manager shall direct, furnish such brokerage houses, if any, and Advisor or such other investment manager with such further information and forms as Advisor or such other investment manager shall from time to time direct, pay, in addition to the Trustee's fees, the fees of Advisor or such other investment manager in accordance with the provisions of such Investment Management Agreement and this Trust Agreement, and perform such

other actions as directed by Advisor or such other investment manager which may be necessary for the Advisor or such other investment manager to perform his or her duties under the Investment Management Agreement all notwithstanding whether the foregoing constitutes, or may constitute, a breach of the terms of this Trust Agreement or a violation of any law applicable to the investment of the property under this Trust Agreement.

Advisor and any such other investment manager may resign on 30 days' written notice to the Trustee, and the Grantor, if living. The Grantor, and following Grantor's death, a majority in interest of the adult beneficiaries and the natural or legal guardians of any minors or otherwise legally disabled beneficiaries to whom income may then be payable or permitted to be paid hereunder may remove the Advisor or such other investment manager by written notice delivered to the Advisor or other investment manager and the Trustee not less than thirty (30) days prior to the effective date of the removal. The persons to whom such notice of resignation may be given or the persons who may exercise the power of removal, as the case may be, may, upon the failure to qualify, declination, resignation, or removal of Advisor or such other investment manager, may appoint any registered investment advisor, wherever situated, as investment manager.

The Trustee shall not be liable or responsible for any loss resulting to any trust estate created under this Trust Agreement or to any present or future beneficiary thereof by reason of following the foregoing provisions or by reason of opening such accounts as directed by Advisor or such other investment manager and the execution of any purchase, sale or other investment related action taken pursuant to and in accordance with the directions of Advisor or such other investment manager, or by reason of failure to make any such transactions or take any other action in the absence of such directions, it being the intention of the Grantor to relieve the Trustee of any duties and responsibilities concerning the investment of the property forming a part of the Trust Agreement and any duties and responsibilities concerning the selection, monitoring and oversight of Advisor or such other investment manager while Advisor or such other investment manager administers such investments, including but not limited to any duty the Trustee may have to apply to any court for instructions notwithstanding the fact that the Trustee has, or with reasonable inquiry should have, actual or constructive notice that any action taken or omitted pursuant to, or as a result of, the exercise of such directive authority constitutes, or may constitute, a breach of the terms of this Trust Agreement or a violation of any law applicable to the investment of the funds held thereunder.

Grantor intends for the provisions of SDCL Section 55-1B-1 through Section 55-1B-5, inclusive, and Section 55-1B-7 to apply to this Article and this Trust Agreement to the extent not inconsistent with the provisions of this Article and this Trust Agreement, such that to the extent not inconsistent with the provisions of this Article and this Trust Agreement, any references to Advisor or such other investment manager shall also be deemed to mean the "Trust Advisor" for purposes of investment authority and where the context permits and any references to the Trustee shall also be deemed to mean the "Excluded Fiduciary" for purposes of investment authority and where the context permits.

In the event of a conflict between the provisions of this Article and the provisions of SDCL Section 55-1B-1 through Section 55-1B-5, inclusive, and Section 55-1B-7, the provisions of this Article and this Trust Agreement shall control.

**NOTE:** If it is desirable for the Trustee to currently handle the investments but the Client would like to avoid potential problems with administration by providing the flexibility for a

beneficiary or another individual to appoint an outside investment manager in the future, the above language could be modified to allow for such appointment.

**3. Providing the Compensation of the Trustee and Investment Manager.**

The following provision can be used to provide for compensation to the trustee and the investment manager.

ARTICLE ________________: In addition to reimbursement of expenses incurred in the performance of their duties under the trusts hereby created, the Trustee and any investment manager shall receive compensation for their services in accordance with their respective published schedule of fees, in effect from time to time, subject, however, to any separate agreement regarding their compensation between the Trustee, such investment manager, the Grantor or the adult beneficiaries and the natural and legal guardians of any minors or otherwise legally disabled beneficiaries to whom income or principal may then be payable or permitted to be paid hereunder, as the case may be. To the extent not prohibited by applicable law: (i) the Trustee shall not notify any beneficiary hereunder of a change in the Trustee's compensation other than those who are then receiving or are entitled or permitted to receive income or principal from any trusts hereunder until such time as the beneficiary is entitled or permitted to receive income or principal from the trust estate; and (ii) any deviation from the Trustee's published schedule of fees in effect from time to time shall be agreed to by the Trustee and those beneficiaries who are then receiving or are entitled or permitted to receive income or principal from any such trust created hereunder, all notwithstanding any contrary provision of applicable law.

# IX. MODIFICATION OF TRUST INSTRUMENTS

In some instances, it may be possible to modify an existing trust instrument that is irrevocable to incorporate some of the bifurcation provisions discussed above. Of course, analysis begins with a review of the existing terms and provisions of the trust instrument. If there are no provisions providing the flexibility to modify, such as a power of amendment by either the Trustee or other third party, such as a trust protector, the parties must look to applicable governing law to determine if modification is possible.

## A. The Uniform Trust Code[214]

The UTC contains several provisions concerning the reformation or modification of a trust. Article Four of the UTC deals with the creation, validity, modification and termination of trusts.

### 1. Modification or Termination By Consent

UTC § 411(a) permits the modification or termination of a non-charitable irrevocable trust with the consent of only the settlor and all beneficiaries.[215] Note neither the consent of the

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[214] For non-UTC states, each state's statutes must be consulted. Only a few examples are provided in this outline.

[215] *See, e.g.,* RSMo § 456.4A-411; KSA § 58a-411; MSA § 501C.0411; ARS § 14-10411; Neb. Rev. St. § 30-3837. For non-UTC states *see, e.g.,* I.C.A. § 633A.2202; SDCL § 55-3-24. The scrivener should consider whether there is any concern that the provisions of UTC § 411 may cause the trust to be included in the settlor's estate under Internal Revenue Code § 2036 and § 2038. According to the Summer 2004 edition of UTC Notes (found at https://my.uniformlaws.org/committees/community-home?CommunityKey=193ff839-7955-4846-8f3c-ce74ac23938d), many, if not most, practitioners do not believe there is likely a problem with the provisions of UTC

Trustee nor the approval of the appropriate court is required. Where a grantor desires to limit the ability of the beneficiaries to modify or terminate a trust by a court solely with their consent or wants to state clearly that he or she shall not have the power to consent to any modification or termination of an irrevocable trust, consider drafting around any such statutory provision.[216]

Under UTC § 411(b), if the settlor does not consent or is not alive, a modification or termination can be approved by the court, based upon the court's determination that, in the case of a termination, that the continuance of the trust is not necessary to achieve the material purpose of the trust, and, in the case of a modification, that it is not inconsistent with a material purpose of the trust. This option requires the consent of all of the beneficiaries.[217]

Section 411(e) of the UTC, however, also provides for the situation in which not all of the beneficiaries consent. Upon this occurrence, the court could approve a modification or termination upon the court's determination that 1) if all of the beneficiaries had consented, the trust could have been modified or terminated under UTC § 411(a) or (b); and 2) the interests of a beneficiary who does not consent would be adequately protected. One should note these requirements carefully and particularly note their interplay with UTC § 111 requirements for nonjudicial settlement agreements and their drafting implications.

### 2. Modification or Termination Because of Unanticipated Circumstances or Inability to Administer the Trust Effectively

UTC § 412 provides that the court has the ability to terminate a trust or modify its dispositive provisions or administrative terms, if certain conditions are met. Such action must be in accordance with the settlor's probable intention. This section also gives the court the ability to modify the administrative terms of a trust if continuing it on its existing terms would be wasteful or impractical or impair the trust's administration. As with UTC § 411, the drafter

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§ 411 since the provisions basically acknowledged common law already in existence. Comfort may also be taken from Treas. Reg. § 20.2038-1(a)(2) that states the settlor does not have a taxable power if the action requires consent of all parties with an interest, either vested or contingent. However, KSA § 58a-411, in particular, raises a potential tax issue. Kansas altered the language to only require the qualified beneficiaries, which may not include all "interested parties" for purposes of Treas. Reg. § 20.2038-1(a)(2), to consent with the settlor. It is possible that a ruling from the IRS may be requested to clear up this issue. It may be possible to draft around both issues in the governing instrument.

[216] *See, e.g.,* UMB 2, Article Two, Paragraph H.

[217] Missouri adopted UTC § 411 in two separate sections. *See* RSMo §§ 456.4A-411, 456.4B-411. In 2016, Missouri amended this section to state that it shall apply to all trusts that were created under trust instruments that became irrevocable prior to, on, or after January 1, 2005, which was the effective date of the MUTC. Previously, the prior law (RSMo § 456.590) applied to trusts that were irrevocable prior to the effective date of the MUTC. *See also* Tex. Prop. Code § 112.054, which addresses judicial modification, reformation and termination of trusts. Under subsection (d), the court may not take action under § 112.054 (a)(5) (continuance of the trust is not necessary to achieve any material purpose of the trust or the order is not inconsistent with a material purpose of the trust) unless all beneficiaries of the trust have consented to the order or are deemed to have consented.

should note these requirements carefully and particularly note their interplay with the UTC § 111 requirements for nonjudicial settlement agreements and their drafting implications.[218]

### 3. Reformation to Correct Mistakes

UTC § 415 provides the court with the ability to reform the terms of the trust agreement to conform to the settlor's intention if it is proved by clear and convincing evidence that both intent and terms of the trust were affected by a mistake of fact or law whether in expression or inducement. According to the UTC comments to this section, "a mistake of expression occurs when the terms of the trust agreement misstate the settlor's intent, fail to include a term that was intended to be included, or include a term that was not intended to be included" and "a mistake in the inducement occurs when the terms of the trust agreement accurately reflect the settlor's intent, but the intention was based upon a mistake in law." Clearly UTC § 415 provides an excellent tool for correcting the inevitable errors that occur in planning and drafting.[219]

### 4. Modification to Achieve the Settlor's Tax Objectives

UTC § 416 provides the court with the power to modify the terms of the trust agreement to achieve the settlor's tax objectives in a manner that is not contrary to the settlor's probable intention. This modification is similar to the power to modify for unanticipated circumstances as provided in UTC § 412. An example of a useful application of this power deals with the inadvertent estate tax inclusion of the assets of a trust for which the Trustee is the beneficiary due to a flaw in the recitation of the ascertainable standard (for example, adding the ability to distribute for the beneficiary's happiness). Presumably, the settlor did not create the trust for the beneficiary with the intent that it be included in his or her estate. UTC § 416 might provide a remedy.[220]

## B. Nonjudicial Settlement Agreements

UTC § 111 allows for nonjudicial settlement agreements.[221] Often when parties are in agreement on the action that should be taken with respect to a certain trust, it might make sense to handle the matter non-judicially in the form of a nonjudicial settlement agreement.

Section 111 gives these settlements the same effect as a court settlement; however, the settlement must contain the terms and conditions a court could properly approve. UTC § 111(d) provides a non-exclusive list of matters that may be resolved by a nonjudicial settlement agreement. These are the following:

1. the interpretation or construction of the terms of a trust;
2. the approval of a Trustee's report or accounting;

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[218] *See, e.g.,* RSMo § 456.4-412; KSA § 58a-412; MSA § 501C.0412; ARS § 14-10412; Neb. Rev. St. § 30-3838. For non-UTC states *see, e.g.,* I.C.A. § 633A.2204; SDCL § 55-3-26; Tex. Prop. Code § 112.054(a).

[219] *See, e.g.,* RSMo § 456.4-415; KSA § 58a-415; MSA § 501C.0415; ARS § 14-10415; Neb. Rev. St. § 30-3841. *See also. e.g.,* Tex. Prop. Code § 112.054.

[220] *See, e.g.,* RSMo § 456.4-416; KSA § 58a-416; MSA § 501C.0416; ARS § 14-10416; Neb. Rev. St. § 30-3842. *See also. e.g.,* Tex. Prop. Code § 112.054(a)(4).

[221] UTC § 111. *See, e.g.,* RSMo § 456.1-111; KSA § 58a-111, MSA § 501C.111; ARS § 14-10111; Neb. Rev. St. § 30-3811. *See also* 760 ILCS 5/16.1(d) and ICA § 633A.6308 for a non-UTC state examples.

3. direction to a Trustee to refrain from performing a particular act or the grant to a Trustee of any necessary or desirable power;
4. the resignation or appointment of a Trustee and the determination of a Trustee's compensation;
5. transfer of a trust's principal place of administration; and
6. liability of a Trustee for an action relating to a trust.

Under § 111(b), the persons who can enter into a nonjudicial settlement agreement are "interested persons," defined in § 111(a) as "persons whose consent would be required in order to achieve a binding settlement were the settlement to be approved by a court." This is not a precise definition. This requirement presumably results in referring to the specific sections outlining the requirements for parties involved in the judicial modification and termination of a trust, for example. Thus, UTC § 111 may provide a potentially powerful tool for flexibility in an estate plan.

There is variance among the states that have adopted the UTC. For example, Kansas has severely restricted UTC § 111 by limiting matters which can be subject to a nonjudicial settlement agreement to the approval of a Trustee's report or accounting, the resignation or appointment of a Trustee and determination of its compensation, the transfer of a trust's principal place of administration, and liability for a Trustee for an action relating to the trust.[222] Notably, Kansas deleted matters relating to the interpretation or construction of the terms of a trust and a direction to a Trustee to refrain from performing a particular act or the grant to a Trustee of any necessary or desirable power. These latter items presumably may not be the subject of a nonjudicial settlement agreement but could be resolved by a court action.

Missouri modified UTC § 111 to provide that a nonjudicial settlement agreement may not be used to terminate or modify a trust for the reasons that a court could terminate or modify a trust as set forth in subsection 1 of RSMo § 456.4B-411.[223]

Illinois, a non-UTC state, amended 760 ILCS 5/16.1(d) effective January 1, 2010, to provide a more liberalized use of a nonjudicial settlement agreement. Like UTC § 111, an Illinois nonjudicial settlement agreement requires the consent of "interested persons," specifically including the Trustee, and requires the terms and conditions be such that a court of competent jurisdiction could approve under applicable law. The statute provides a non-exclusive list of items that may be resolved by a nonjudicial settlement agreement, as follows:

> (A) interpretation or construction of the terms of the trust; (B) approval of a trustee's report or accounting; (C) exercise or nonexercise of any power by a trustee; (D) the grant to a trustee of any necessary or desirable administrative power; (E) questions relating to property or an interest in property held by the trust; (F) resignation or appointment of a trustee; (G) determination of a trustee's compensation; (H) transfer of a trust's principal place of administration; (I) liability or indemnification of a trustee for an action relating to the trust; (J) resolution of disputes or issues related to administration, investment, distribution or other matters; (K) modification of terms of the trust pertaining to administration of the trust; and (L) termination of the trust, provided that court approval of such termination must be obtained in accordance with [760 ILCS 5/16.1(d)(5)], and the court must conclude continuance of the trust is not necessary to achieve any material

[222] KSA § 58a-111(d).
[223] RSMo § 456.1-111.6.

purpose of the trust; upon such termination the court may order the trust property distributed as agreed by the parties to the agreement or otherwise as the court determines equitable consistent with the purposes of the trust.

## C. Court Reformation

In non-UTC states, a court reformation proceeding is a possible method for changing the terms and provisions of an irrevocable trust to incorporate bifurcation of duties. The court can alter the terms of a trust instrument to enable the trustee to carry out the intent of the grantor that would not otherwise be fulfilled if the document were not modified. In many cases, a court will only reform a trust instrument only if the document, as it exists, frustrates the grantor's intent due to changes circumstances that could not have been anticipated by the grantor at the time of execution.[224]

## D. Decanting

In general, decanting is the process by which a Trustee of an irrevocable trust (the "transferor trust") with discretionary powers over trust principal, without court approval, transfers the principal into a new trust or a separate, currently existing trust (the "transferee trust"). The trust principal is then subject to a trust instrument that has terms different from the previous trust instrument that will allow the Trustee and beneficiaries to accomplish various objectives.

Decanting can be used for numerous purposes, including:

- fixing errors or ambiguities in the existing trust instrument;
- providing the Trustee with more flexibility regarding, for example, trust investments or the use of trust advisors;
- revising Trustee compensation;
- restricting, if possible, duties owed to the beneficiaries, such as the duty to provide information;
- avoiding state income tax;
- fortifying spendthrift provisions or otherwise protecting assets from the beneficiaries' creditors;
- dividing a trust into separate trusts; and
- altering beneficial interests (e.g., to postpone outright distributions or to establish a special needs trust for a beneficiary who has become disabled since the transferor trust was established.)[225]

### 1. Decanting Statutes

As of the date of this outline, states with decanting statutes include Alabama, Alaska, **Arizona**, California, **Colorado**, Delaware, Florida, **Illinois**, Indiana, Kentucky, Michigan,

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[224] *See, e.g.,* ICA § 633A-2204–2206; SDCL § 55-3-26; Tex. Prop. Code § 112.054.

[225] Anne Marie Levin and Todd A. Flubacher, *Put Decanting to Work to Give Breath to Trust Purpose,* Est. Pln., Jan. 2011, at 3.

**Minnesota**, **Missouri**, Nevada, New Hampshire, New Mexico, New York, North Carolina, Ohio, Rhode Island, South Carolina, **South Dakota**, Tennessee, **Texas**, Virginia, Washington, Wisconsin and Wyoming (UMB footprint states are highlighted).[226] In addition, the Uniform Trust Decanting Act was adopted by NCCUSL in 2015.[227] Each state statute provides detailed requirements to effectuate a decanting. A detailed discussion about decanting is beyond the scope of this outline. The Missouri and Texas statutes are discussed as examples.

Among the requirements of the Missouri decanting statute are:

a. The Trustee of the transferor trust must have a discretionary power to distribute income or principal to one or more beneficiaries. This requirement is hereinafter referred to as the “threshold discretionary power”.

b. The decanting must be “necessary or desirable” after taking certain specified factors into account.

c. The beneficiaries of the transferee trust must be only certain beneficiaries of the first trust, identified according to the rules set forth in RSMo § 456.4-419.2(1).

d. The Trustee is generally required to provide 60 days' notice of the decanting to the permissible distributees of the transferee trust (or, if there are no permissible distributees of such trust, to the qualified beneficiaries of such trust).

Missouri also imposes several limitations on the Trustee's decanting authority. For example:

a. If the threshold discretionary power is not limited by an ascertainable standard, then (1) no Trustee who is a beneficiary of the transferor trust can exercise the statutory decanting authority, and (2) the statutory decanting authority cannot be exercised by any Trustee, so long as any beneficiary of the transferor trust can remove and replace the Trustee of such trust with a related or subordinate party to such beneficiary within the meaning of IRC § 672(c).

b. Unless the decanting is “needed for a distribution to any such beneficiary under an ascertainable standard,” the decanting authority cannot be used to the extent that it would

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[226] Ala Code § 19-3d-1 *et seq.*; A.S. §§ 13.36.157–13.36.159, 13.36.215; A.R.S. § 14-10819; Cal. Prob. Code § 19501 *et seq.*; CRS § 15-16-901 *et seq.*; 12 Del. C. § 3528; Fla. Stat. § 736.04117; 760 ILCS 5/16.4; Ind. Code Ann. § 30-4-3-36; Ky. Rev. Stat. § 386.175; Mich. Comp. Laws §§ 556.116a, 700.7820a; MSA § 502.851; RSMo § 456.4-419; Nev. Rev. Stat. § 163.556; N.H. Rev. Stat. §§ 564-B:4-418, 419; N.M.S.A. § 46-12-101 *et seq.*; NY EP&TL § 10-6.6; N.C.G.S.A. § 36C-8B; Ohio Rev. Code § 5808.18; R.I. Gen. Laws 1956, § 18-4-31; S.C. Code Ann. 1976 § 62-7-816A; SDCL §§ 55-2-15–21; Tenn. Code Ann. § 35-15-816(b)(27); Tex. Prop. Code §§ 112.071–087; Va. Code Ann. § 64.2-779; Wash. Rev. Code §§ 11.001.001–.008; Wis. Stat. § 701.0418; Wyo. Stat. Ann. 1977 § 4-10-816(a)(xxviii), (b). For a summary of decanting statutes current through the date of the preparation of the summary, *see* ACTEC State Surveys, *Summaries of State Decanting Statutes*, https://www.actec.org/assets/1/6/Bart-State-Decanting-Statutes.pdf.

[227] https://www.uniformlaws.org/viewdocument/final-act-with-comments-92?CommunityKey=5b248bac-9251-47fb-bad8-57a23f3df540&tab=librarydocuments. As of the date of this outline, the Uniform Trust Decanting Act has been adopted in Alabama, California, Colorado, New Mexico, North Carolina, Virginia and Washington. *See* https://my.uniformlaws.org/committees/community-home?CommunityKey=5b248bac-9251-47fb-bad8-57a23f3df540.

either: (1) increase the distributions that can be made in the future from the transferee trust to either (a) the Trustee of the transferor trust or (b) a beneficiary who can remove and replace the Trustee of the transferor trust with a related or subordinate party to such beneficiary within the meaning of IRC § 672(c) or (2) remove restrictions on discretionary distributions imposed by the instrument under which the transferor trust was created.

c. The decanting authority cannot be used to: (1) postpone the vesting of trust contributions that have been treated as qualifying for the annual gift tax exclusion of IRC § 2503(b) by reason of IRC § 2503(c), (2) decrease the income interest of any beneficiary of: (a) "a trust for which a marital deduction has been taken," (b) a CRT, (c) a GRAT, or (d) a QSST or an ESBT, or (3) change a presently exercisable power of withdrawal held by a beneficiary to or for whom the Trustee has authority to make distributions.

Texas, by contrast, has a statutory scheme, rather than a single statute, and has split its decanting analysis based upon what the Trustee's discretionary authority is. If the Trustee has unlimited discretionary authority to distribute principal, then the statute has very few restrictions on what is in the second trust.[228] If, on the other hand, the Trustee's discretion is limited, then its ability to decant will likewise be restricted.[229] In both situations, however, the Trustee may not eliminate beneficiary's mandatory distribution rights as to income or withdrawal rights.[230] It has a number of similar tax savings provisions to the Missouri statute as well.[231]

Unlike Missouri, Texas only requires 30 days of notice to interested parties prior to decanting.[232] In addition, Texas explicitly states that the intention of the statutes is to be a codification of the common law,[233] which may expand the applicability of the decanting provision, as that specific language may permit application of decanting statutes to trusts in existence prior to the enacting date. It also denies that the Trustee has a duty to exercise the power to decant or even inform beneficiaries of the existence of the power to decant.[234] Finally, a unique provision to Texas is that it explicitly addresses the question of after-acquired property that would flow into post-decanting Trust—the outcome depends on whether the decanting was partial or complete, as a partial decanting will not carry after-acquired assets with it but a complete decanting will.[235]

### 2. Tax Implications of Decanting

When transferring trust property through a decanting to a transferee trust that has different dispositive provisions, the attorney must ensure that the decanting does not create any adverse gift or estate tax issues. These issues may arise if the governing instrument of the

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[228] Tex. Prop. Code § 112.072.
[229] Tex. Prop. Code § 112.073.
[230] Tex. Prop. Code § 112.085(1).
[231] Tex. Prop. Code § 112.086.
[232] Tex. Prop. Code § 112.074.
[233] Section 8, Texas H.B. No. 2913 (2013).
[234] Tex. Prop. Code § 112.083.
[235] Tex. Prop. Code § 112.080.

transferee trust creates new interests such as, for example, a general power of appointment. These issues also may arise if the transfer to the transferee trust is an incomplete gift that becomes complete on the death of a beneficiary.[236]

Decanting statutes typically do not require the consent of any beneficiary.[237] The omission of a beneficiary consent requirement helps avoid any adverse gift tax consequences attributable to the beneficiaries that may arise due to the decanting. A beneficiary's consent may give rise to adverse transfer tax consequences, for example, if the governing instrument of the transferee trust provides such beneficiary with less of an interest than under the transferor trust and provides a greater interest to the beneficiary's child. Through the beneficiary's consent, the beneficiary may be considered as participating in the decanting to the same extent as the Trustee, thereby making a gift of part of his or her trust interest to his or her child.

Another related issue is the possible transfer tax consequences arising from a decanting by a Trustee who is also a beneficiary of the transferor or transferee trust. The Missouri statute takes steps to address this problem by providing, as described above, that a Trustee of the transferor trust cannot participate in a decanting if the Trustee is a beneficiary of the transferor trust or any beneficiary of the transferor trust can remove and replace the Trustee with a related or subordinate party, unless the Trustee's threshold discretionary power is limited by an ascertainable standard.[238] Texas has a slightly different approach: it limits the availability of decanting by interested Trustee with a discretionary power to being only able to exercise that power subject to an ascertainable standard.[239]

Further, the Missouri statute addresses not only the standard of distribution necessary under the transferor trust but also the standard of distribution necessary under the transferee trust. As described above, the Missouri statute requires that the decanting cannot have the effect of: (1) increasing the distributions that can be made in the future from the transferee trust to either (a) the Trustee of the transferor trust or (b) a beneficiary of the transferor trust who can remove and replace the Trustee of the transferor trust with a related or subordinate party, or (2) removing restrictions on discretionary distributions imposed under the instrument that created the transferor trust.[240]

### 3. Trustee Liability

The Trustee must ensure that the risks of fiduciary liability arising from the decanting are minimized. This will be especially important if the transferee trust changes the interests of the current or remainder beneficiaries. Typically, with transactions other than decanting, the Trustee will seek the written consent of the beneficiaries to the transaction to minimize the risk of fiduciary liability. The consent may be more difficult to obtain for a decanting, however, because, as discussed above, one or more beneficiaries may refuse consent to avoid adverse transfer tax consequences arising from the decanting. In situations in which

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[236] IRC § 2041(a); Levin and Flubacher, *Put Decanting to Work to Give Breath to Trust Purpose*.
[237] Levin and Flubacher, *Put Decanting to Work to Give Breath to Trust Purpose.*
[238] RSMo § 456.4-419.2.
[239] Tex. Prop. Code § 113.029(b).
[240] RSMo § 456.4-419.3.

beneficiary consent can be obtained, the Trustee and his, her or its attorney should ensure that as many beneficiaries as possible, including current and remainder beneficiaries, whether contingent or vested, are bound by the consents under applicable state law. If the decanting leads to the termination of the transferor trust, a Trustee, especially a corporate Trustee, may treat a decanting as any other trust termination and require the beneficiaries to follow its trust termination procedures, which may include a multiple releases and indemnifications, as well as a court's approval of an accounting. Additional procedures may be required if the assets are being transferred to a new trust, even if the Trustee and beneficiaries of the transferor and transferee trusts are the same.[241]

# X. ADDITIONAL SAMPLE LANGUAGE

## A. Applicable Law

The trust agreement should provide for the applicable law governing the construction, administration and validity of the trusts created. It is possible to bifurcate the governing law for issues of administration from issues of construction and validity, which can provide flexibility for the Trustee in applying law with which it is familiar in handling administration issues which may arise from time to time. Consider whether the attorney has the duty to advise the client as to the most favorable jurisdiction with regard to the trust prior to its creation. The following is a sample provision designating the state law that will govern a trust's construction, administration and validity.

> ARTICLE ____: GOVERNING LAW
>
> This instrument shall be construed and administered, and the validity of the trusts hereby created shall be determined, in accordance with the laws of the State of __________________. The Trustee shall have no duty to monitor whether the trusts created herein are being administered at a place appropriate to the trust's purposes, its administration and the interests of the beneficiaries.[242]

## B. Change of Situs

It is also possible for the Trustee to change the situs of the trust's administration, thus providing flexibility in selecting what might be a more favorable forum for trust administration under the changed future circumstances.[243] The advantage of granting the Trustee such discretion in the trust agreement, rather than utilizing state law to do so, is that the grantor can set his or her own limits and guidelines for such change and need not provide the statutorily required notice of change of situs to qualified beneficiaries and may vest the discretion to change situs solely in the Trustee. It may also be helpful to override the provisions of state law which might be construed as requiring the Trustee to monitor continuously whether the trust is being administered in the most favorable jurisdiction possible. The following is a sample provision allowing the Trustee to

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[241] Levin and Flubacher, *Put Decanting to Work to Give Breath to Trust Purpose.*

[242] UMB 2, Article Twelve. It might also be possible for the Trustee to change applicable law, at least under the UTC. *See, e.g.,* ARS § 14-10108.C; KSA § 58a-108(c); RSMo § 456.1-108(c); MSA § 501C.0108(c); Neb. Rev. St. § 30-3038(c).

[243] *See, e.g.,* ARS § 14-10108.C; KSA § 58a-108(c); RSMo § 456.1-108(c); MSA § 501C.0108(c); Neb. Rev. St. § 30-3038(c).

change situs:

> The situs of each trust created hereunder is the state of Grantor's domicile, or, if Grantor is then deceased, the state of Grantor's domicile at the time of Grantor's death. The Trustee may move any property of any trust estate created under this Agreement from one jurisdiction to another and, by written instrument, may from time to time remove the situs of any trust created under this Agreement to any other jurisdiction as the trustee may deem advisable in its discretion. All questions pertaining to the administration of any trust created under this Agreement shall be determined in accordance with the laws of the situs of such trust. The Trustee may provide from time to time, by written instrument, that questions pertaining to the administration of a trust shall thereafter be determined in accordance with the laws of any other jurisdiction. All questions pertaining to the administration, validity, construction and interpretation of any trust created under this Agreement shall be determined in accordance with the laws of the State of _________, regardless of whether the situs of such trust may have been changed as provided in this Paragraph. The Trustee shall have no duty to monitor whether the trusts created herein are being administered at a place appropriate to the trust's purposes, its administration and the interests of the beneficiaries.

UTC § 108[244] deals with the principal place of administration of the trust and appears to impose a continuing duty on the Trustee to administer the trust in the most appropriate place. The Trustee may also transfer the principal place of administration by following the statutory procedures. Query: Does the Trustee have the affirmative duty to "forum shop" to ensure that the trust is being administered in a state with the most favorable tax laws?…the most favorable laws applicable to trust administration?...the most favorable asset protection statutes? Under UTC § 108(c) and (d), the Trustee may transfer the trust's principal place of administration to another state or jurisdiction, with notice to the qualified beneficiaries. However, if a beneficiary objects, the Trustee's power terminates. Under UTC § 108(c), the Trustee could still seek court approval if it believed the transfer was necessary. If the grantor does not wish to grant this power to the Trustee, the governing instrument should so provide, but forbidding change of situs may create inflexibility for long term trusts.

## XI. CONCLUSION

While bifurcation of trustee duties may be possible, using a variety of means, this area of estate planning is evolving and bifurcation, if desired, needs to be carefully considered, taking into account the needs and objectives of the grantor and his or her beneficiaries. As with all estate planning, precise drafting is necessary, often in consultation with the trustee or successor trustee, in order to have a more likely successful outcome than not.

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[244] *Id.*

# Appendix 1: Co-Trustee Statutes—UTC States

As of February 2019

| | UTC | Missouri | Kansas | Nebraska | Arizona | Minnesota | Colorado |
|---|---|---|---|---|---|---|---|
| **Code Sections** | UTC § 703 | RSMo § 456.7-703 | KSA § 58a-703 | Neb. Rev. St. § 30-3859 | ARS § 14-10703 | MSA § 501C.703 | CRS § 15-5-703* |
| **Unanimous or Majority Rule** | Majority decision UTC § 703(a) | Majority decision RSMo § 456.7-703.1 | Majority decision KSA § 58a-703(a) | Majority decision Neb. Rev. St. § 30-3859(a) | Majority decision ARS § 14-10703.A | Majority decision MSA § 501C.703(a) | Majority Decision CRS § 15-5-703(1) |
| **Remaining Co-Trustees ability to act if Vacancy** | Yes UTC § 703(b) | Yes RSMo § 456.7-703.2 | Yes KSA § 58a-703(b) | Yes Neb. Rev. St. § 30-3859(b) | Yes ARS § 14-10703.B | Yes MSA § 501C.703(b) | Yes CRS § 15-5-703(2) |
| **Exceptions to duty to participate** | Absence, illness, disqualification under other law, or other temporary incapacity or the cotrustee has properly delegated the performance to another trustee UTC § 703(c) | Absence, illness, disqualification under other law, or other temporary incapacity or the cotrustee has properly delegated the performance to another trustee RSMo § 456.7-703.3 | Absence, illness, disqualification under other law, or other temporary incapacity or the cotrustee has properly delegated the performance to another trustee KSA § 58a-703(c) | Absence, illness, disqualification under other law, or other temporary incapacity or the cotrustee has properly delegated the performance to another trustee Neb. Rev. St. § 30-3859(c) | Absence, illness, disqualification under other law or other temporary incapacity or the cotrustee has properly delegated the performance to another trustee ARS § 14-10703.C | Absence, illness, disqualification under other law, or other temporary incapacity or the cotrustee has properly delegated the performance of the function to another trustee MSA § 501C.703(c) | Absence, illness, disqualification, or other temporary incapacity or the cotrustee has properly delegated the performance of the function to another trustee. CRS § 15-5-703(3) |
| **Ability to act if co-trustee unavailable** | If a cotrustee is unavailable and prompt action is necessary to achieve purposes of the trust or to avoid injury to the trust property UTC § 703(d) | If a cotrustee is unavailable and prompt action is necessary to achieve purposes of the trust or to avoid injury to the trust property RSMo § 456.7-703.4 | If a cotrustee is unavailable and prompt action is necessary to achieve purposes of the trust or to avoid injury to the trust property KSA § 58a-703(d) | If a cotrustee is unavailable and prompt action is necessary to achieve the purposes of the trust or to avoid injury to the trust property Neb. Rev. St. § 30-3859(d) | If a cotrustee is unavailable and prompt action is necessary to achieve the purposes of the trust or to avoid injury to the trust property ARS § 14-10703.D | If a cotrustee is unavailable and prompt action is necessary to achieve the purposes of the trust or to avoid injury to the trust property MSA § 501C.703(d) | If a cotrustee is unavailable and prompt action is necessary to achieve the purposes of the trust or to avoid injury to the trust property CRS § 15-5-703(4) |

# Appendix 1: Co-Trustee Statutes—UTC States

As of February 2019

| | UTC | Missouri | Kansas | Nebraska | Arizona | Minnesota | Colorado |
|---|---|---|---|---|---|---|---|
| **Delegation to Other Co-Trustees** | No function the settlor reasonably expected the trustees to perform jointly.<br>UTC § 703(e) | A trustee may delegate to a cotrustee in accordance with § 456.8-807.1 (agents and powers that a prudent trustee of comparable skills could properly delegate)<br>RSMo § 456.7-703.5 | No function the settlor reasonably expected the trustees to perform jointly.<br>KSA § 58a-703(e) | No function the settlor reasonably expected the trustees to perform jointly.<br>Neb. Rev. St. § 30-3859(e) | Any function unless the terms of the trust provide that the trustees perform jointly. Investment and management functions if the reasonably belief of greater investment skills.<br>ARS §§ 14-10703.E, 14-10907.E | Any duties or powers as prudent under the circumstances.<br>MSA § 501C.703(e) | No function the settlor reasonably expected the trustees to perform jointly.<br>CRS § 15-5-703(5) |
| **Liability of Co-Trustees for Acts of Other Co-Trustees** | Not liable unless a breach of trust if notice of dissent provided to cotrustees<br>UTC § 703(h) | Not liable unless a serious breach of trust if notice of dissent provided to cotrustees<br>RSMo § 456.7-703.8 | Not liable if notice of dissent, in writing, provided to cotrustees<br>KSA § 58a-703(h) | Not liable unless a serious breach of trust if notice of dissent provided to cotrustees<br>Neb. Rev. St. § 30-3859(h) | Not liable unless a material breach of trust if notice of dissent provided to cotrustees<br>ARS § 14-10703.H | Not liable unless a serious breach of trust if notice of dissent provided to any cotrustee<br>MSA § 501C.703(h) | Not liable unless a serious breach of trust if notice of dissent provided to any cotrustee<br>CRS § 15-5-703(8) |

# Appendix 2: Co-Trustee Statutes—Non-UTC States

As of February 2019

| | South Dakota | Illinois | Iowa | Texas |
|---|---|---|---|---|
| **Code Section** | Title 55 | 760 ILCS 5 | Iowa Code § 633A | Title 9, Subtitle B |
| **Unanimous or Majority Rule** | Majority if 3 or more Trustees; Unanimous if two Trustees<br>SDCL § 55-4-3 | Majority decision if 3 or more Trustees<br>760 ILCS 5/10 | Majority Decision.<br>ICA § 633A.4103(1) | Majority decision<br>Tex. Prop. Code § 113.085(a) |
| **Remaining Co-Trustees ability to act if Vacancy** | Yes | Yes<br>760 ILCS 5/13 | Yes<br>ICA § 633A.4103 | Yes<br>Tex. Prop. Code § 113.085(b) |
| **Exceptions to duty to participate** | Absence, illness, disqualification under other law, or other incapacity<br>SDCL § 55-4-50 | Not Specified | Absence, illness, or other temporary incapacity<br>ICA § 633A.4103(4) | Absence, illness, suspension under law, disqualification, other temporary incapacity, or has delegated performance of the function to another trustee.<br>Tex. Prop. Code § 113.085(c) |
| **Ability to act if co-trustee unavailable** | If a co-trustee is unable to perform duties or fails to perform duties due to inaction or neglect, and action is necessary or appropriate under the circumstances to achieve the purposes of the trust or to avoid injury to the trust property.<br>SDCL § 55-4-50 | Majority of the trustees can act after prior written notice to, or written waiver of notice by, each other trustee.<br>760 ILCS 5/10 | If a co-trustee is unavailable to perform duties, the remaining co-trustees may act for the trust, as if they were the only trustees, if necessary or accomplish the purposes of the trust or to avoid irreparable injury to the trust property.<br>ICA § 633A.4103(2) | If co-trustee is unavailable and prompt action necessary to achieve efficient administration or purposes of the trust or to void injury to the trust property or a beneficiary.<br>Tex. Prop. Code § 113.085(d) |
| **Delegation to other Co-Trustees** | Not Specified | Any or all of the trustee's rights, powers and duties.<br>760 ILCS 5/4.10 | Not the entire administration of the trust or the responsibility to make or participate in the making of decisions with respect to discretionary distributions; otherwise any functions that a prudent trustee of comparable skills might delegate under similar circumstances (UPIA).<br>ICA § 633A.4206(1) | Unless settlor specifically directs the function be performed jointly.<br>Tex. Prop. Code § 113.085(e) |
| **Liability of Co-Trustees for Acts of Other Co-Trustees** | Liable for wrongful acts of a co-trustee to which he consented or which by his negligence he enabled the latter to commit<br>Not liable if notice of dissent provided in writing to any cotrustee<br>Liable for inactivity in the administration of the trust and failure to attempt to prevent a breach of trust.<br>SDCL §§ 55-2-11; 55-4-4; 55-4-5 | No liability<br>760 ILCS 5/10 | Not liable if reasonable steps to prevent a breach of trust or to redress a breach of trust<br>Not liable if notice of dissent provided in writing to any cotrustee<br>Liable for failure to discharge a cotrustee's duties as a trustee.<br>ICA §§ 633A.4208; 633A.4602 | Not liable unless does not exercise reasonable care to prevent a serious breach of trust, if notice of dissent provided to any cotrustee<br>Tex. Prop. Code § 114.006 |

# Appendix 3: Trust Delegation Statutes—UTC States

As of February 2019

| | UTC | Missouri | Kansas | Nebraska | Arizona | Minnesota | Colorado |
|---|---|---|---|---|---|---|---|
| **Code Sections** | UTC § 807 | RSMo § 456.8-807 | KSA § 58a-807 | Neb. Rev. St. § 30-3873 | ARS § 14-10807 | MSA § 501C.0807 | CRS § 15-5-807* |
| **Duties Delegable** | If a prudent trustee of comparable skills could properly delegate under the circumstances UTC § 807(a) | If a prudent trustee of comparable skills could properly delegate under the circumstances RSMo § 456.8-807.1 | If a prudent trustee of comparable skills could properly delegate under the circumstances KSA § 58a-807(a) | N/A | If a prudent trustee of comparable skills could properly delegate under the circumstances ARS § 14-10807.A | If a prudent trustee of comparable skills could properly delegate under the circumstances MSA § 501C.0807(a) | If a prudent trustee of comparable skills could properly delegate under the circumstances. CRS § 15-5-807(1) |
| **Due Diligence Requirements** | None specified | None specified | None Specified | N/A | None Specified | None Specified | None Specified |
| **Trustee's Standard of Care** | Reasonable care, skill, and caution UTC § 807(a)(1) and (2) | Reasonable care, skill, and caution RSMo § 456.8-807.1(1) and (2) | Reasonable care, skill, and caution KSA § 58a-807(a)(1) and (2) | N/A | Reasonable care, skill, and caution ARS § 14-10807.A(1) and (2) | Reasonable care, skill, and caution MSA § 501C.0807(a)(1) and (2) | Reasonable care, skill, and caution CRS § 15-5-807(1) |
| **Agent's Standard of Care** | Reasonable Care UTC § 807(b) | Reasonable care RSMo § 456.8-807.2 | Reasonable care KSA § 58a-807(c) | N/A | Reasonable care ARS § 14-807.B | Reasonable care MSA § 501C.0807(b) | Reasonable Care CRS § 15-5-807(2) |
| **Trustee's Duty to Oversee and Review Agent Acts** | Periodically review to monitor s performance and compliance UTC § 807(a)(3) | Periodically review to monitor performance and compliance RSMo § 456.8-807.1(3) | Periodically review to monitor performance and compliance KSA § 58a-807(a)(3) | N/A | Periodically review to monitor performance and compliance ARS § 14-10807.A(3). | Periodically review to monitor performance and compliance MSA § 501C.0807(a)(3) | Periodically review to monitor performance and compliance CRS § 15-5-807(1)(c) |
| **Trustee's Liability for the Acts of an Agent** | Not liable if complies with duty to select and oversee UTC § 807(c) | Not liable if complies with duty to select and oversee RSMo § 456.8-807.3 | Not liable if complies with duty to select and oversee KSA § 58a-807(d) | N/A | Not liable if complies with duty to select and oversee ARS § 14-10807.C. | Not liable if complies with duty to select and oversee MSA § 501C.703(h) | Not liable if complies with duty to select and oversee CRS § 15-5-807(3) |
| **Extra Notes** | | | | Neb. Rev. St. § 30-3873 merely refers to the UPIA delegation statute | | | |

# Appendix 4: Trust Delegation Statutes under UPIA—UTC States

As of February 2019

| | UPIA | Missouri | Kansas | Nebraska | Arizona | Minnesota | Colorado |
|---|---|---|---|---|---|---|---|
| **Code Sections** | UPIA Section 9 | RSMo § 469.909 | KSA § 58-24a09 | Neb. Rev. St. § 30-3888 | ARS § 14-10907 | N/A | CRS § 15-1.1-109 |
| **Duties Delegable** | If a prudent trustee of comparable skills could properly delegate under the circumstances UPIA § 9(a) | If a prudent trustee of comparable skills could properly delegate under the circumstances. RSMo § 469.909.1 | If a prudent trustee of comparable skills could properly delegate under the circumstances KSA § 58-24a09(a) | If a prudent trustee of comparable skills could properly delegate under the circumstances Neb Rev. Stat. § 30-3888(a) | If a prudent investor of comparable skills might delegate under the circumstances ARS § 14-10907.A | N/A | If a prudent trustee of comparable skills could properly delegate under the circumstances. CRS § 15-1.1-109(a) |
| **Due Diligence Requirements** | None specified | Take into account nature and value of the assets and expertise of agent when selecting RSMo § 469.909.1(1) | Conduct an inquiry into experience of the agent Must send written notice of delegation KSA § 58a-24a09(a)(2), (3) | None Specified | None Specified | N/A | None Specified |
| **Trustee's Standard of Care** | Reasonable care, skill, and caution UPIA § 9(a)(1) and (2) | Reasonable care, skill, and caution RSMo § 469.909.1(1), (2) | Reasonable care, skill, and caution KSA § 58-24a09(a)(1) | Reasonable care, skill, and caution Neb. Rev. St. § 30-3888(a)(1), (2) | Reasonable care, skill, and caution ARS § 14-10907.B, E | N/A | Reasonable care, skill, and caution CRS § 15-1.1-109(a)(1) and (a)(2) |
| **Agent's Standard of Care** | Reasonable care UPIA § 9(b) | Reasonable care RSMo § 469.909.2 | Same standards applicable to Trustee KSA § 58-24a09(b), (c) | Reasonable care Neb. Rev. St. § 30-3888(b) | Reasonable care, skill and caution ARS § 14-10907.C | N/A | Reasonable Care CRS § 15-1.1-109(b) |
| **Trustee's Duty to Oversee and Review Agent Acts** | Periodically review to monitor performance and compliance UPIA § 9(a)(3) | Periodically review to monitor performance and compliance RSMo § 469.909.1(3) | Periodically review to monitor performance and compliance KSA § 58-24a09(a)(1) | Periodically review to monitor performance and compliance Neb. Rev. St. § 30-3888(a)(3) | Periodically review to monitor performance and compliance ARS § 14-10907.B, E | N/A | Periodically review to monitor performance and compliance CRS § 15-1.1-109(a)(3) |
| **Trustee's Liability for the Acts of an Agent** | Not liable if complies with duty to select and oversee UTC § 807(c) | Not liable if complies with duty to select and oversee RSMO § 469.909.3 | Not liable if complies with duty to select and oversee KSA § 58-24a09 | Not liable if complies with duty to select and oversee Neb. Rev. St. § 30-3888(c) | Not liable if complies with duty to select and reviewing ARS § 14-10907.B | N/A | Not liable if complies with duty to select and oversee CRS § 15-1.1-109(c) |
| **Extra Notes** | | | | | | Not in Minnesota UPIA | |

# Appendix 5: Trust Delegation Statutes—Non-UTC States

As of February 2019

| | South Dakota | Illinois | Iowa | Texas |
|---|---|---|---|---|
| **Code Section** | SDCL § 55-5-16 (UPIA) | 760 ILCS 5/5.1 | ICA § 633A.4206 | Tex. Prop. Code §117.011 (UPIA) |
| **Duties Delegable?** | If a prudent person might delegate those responsibilities to others.<br>SDCL § 55-5-16 | Duty not to delegate any acts involving the exercise of judgment and discretion, except if a prudent investor of comparable skills might delegate under the circumstances.<br>760 ILCS § 5/5.1(a) | Shall not delegate entire administration or discretionary distributions, but permitted if a prudent trustee of comparable skills might delegate under similar circumstances.<br>ICA § 633A.4206(1) | If a prudent trustee of comparable skills could properly designate under the circumstances.<br>Tex. Prop. Code § 117.011(a) |
| **Due Diligence Requirements** | Avoid gross negligence or willful misconduct in selection of agent<br>SDCL § 55-5-16 | Conduct an inquiry into the experience of the agent.<br>760 ILCS 5/5.1(b)(2) | None Specified | None Specified |
| **Trustee's Standard of Care** | Willful misconduct or gross negligence<br>SDCL § 55-5-16 | Reasonable care, skill, and caution<br>760 ILCS 5/5.1(b)(1) | Reasonable care, skill, and caution<br>ICA § 633A.4206(2)(a) and (b) | Reasonable care, skill, and caution<br>Tex. Prop. Code § 117.011(a)(1) and (2) |
| **Agent's Standard of Care** | Not Specified | Same standards applicable to Trustee<br>760 ILCS 5/5.1(b) (4), (5) | Reasonable Care<br>ICA § 633A.4206(4) | Reasonable Care<br>Tex. Prop. Code § 117.011(b) |
| **Trustee's Duty to Oversee and Review Agent Acts?** | Avoid gross negligence or willful misconduct in monitoring<br>SDCL § 55-5-16 | Periodically review to monitor performance and compliance<br>760 ILCS 5/5.1(b)(1) | Periodically review performance and compliance<br>ICA § 633A.4206(1)(c) and (d) | Periodically review to monitor performance and compliance<br>Tex. Prop. Code § 117.011(a)(3) |
| **Trustee's Liability for the Acts of an Agent** | May seek approval of delegation. If given, not liable except for willful misconduct or gross negligence<br>SDCL § 55-5-16 | Not liable if complies with duty to select and oversee<br>760 ILCS 5/5.1(c) | Not liable if complies with duty to select and oversee.<br>ICA § 633A.4206(3) | Not liable if complies with duty to select and oversee unless:<br>• An affiliate<br>• Under the terms of the delegation: (A) required to arbitrate disputes with agent; or (B) the period for bringing an action is shortened from applicable law.<br>Tex. Prop. Code § 117.011(c) |
| **Extra Notes** | South Dakota does not have separate statutes for delegation of investment and non-investment fiduciary functions. | Illinois does not have separate statutes for delegation of investment and non-investment fiduciary functions. | Iowa does not have separate statutes for delegation of investment and non-investment fiduciary functions. | Texas has adopted the prudent investor act, which allows for the delegation of investment and management functions. |

# Appendix 6: Directed Trust and Trust Protector Statutes—Part 1

As of February 2019

| | UTC | Missouri | Kansas | Nebraska | Iowa | Arizona |
|---|---|---|---|---|---|---|
| **Code Sections** | UTC § 808 | RSMO § 456.8-808 | KSA § 58a-808 | Neb. Rev. St. § 30-3873 | ICA § 633A.4207 | ARS §§ 14-10808; 14-10818 |
| **Trustee's Duty With Respect To The Directing Party** | Act in accordance with direction unless manifestly contrary to terms of trust or serious breach of fiduciary duty by director<br>UTC § 808(b) | Carry out written directions of trust protector<br>RSMo § 456.8-808.8 | Act in accordance with direction unless manifestly contrary to terms of trust or serious breach of fiduciary duty by director<br>KSA § 58a-808(b) | Act in accordance with direction unless manifestly contrary to terms of trust or serious breach of fiduciary duty by director<br>Neb. Rev. St. § 30-3873(b) | Act in accordance with direction unless violates terms of trust or knowledge of director's incompetence<br>ICA § 633A.4207(2) | No duty to review directions or notify beneficiaries<br>A.R.S. § 14-10808.B |
| **Trustee Liability for Directing Party's Actions** | Not Specified | Not liable if acting pursuant to written direction<br>RSMO § 456.8-808.8 | Not Specified | Not Specified | Not Specified | Not liable if acting pursuant to direction, unless bad faith or reckless indifference<br>ARS § 14-10808.B |
| **Directed Powers Expressly Authorized** | Certain Actions of the Trustee; Modification or termination<br>UTC § 808(b), (c) | Powers include, but not limited to:<br>• Remove and appoint a trustee<br>• Modify or amend<br>• Changing beneficial interests<br>• Terminate the trust<br>• Change applicable law or trust situs<br>• Other powers expressly granted<br>RSMO § 456.8-808.3 | Modification or termination<br>KSA § 58a-808(c)<br>(Same as UTC) | Modification or termination<br>Neb. Rev. St. § 30-3873(c)<br>(same as UTC) | Not Specified | Direction as to Trust Assets, Modification or termination<br>ARS § 14-10808.B, .C<br>Trust Protector Powers may include:<br>• Remove and appoint a trustee<br>• Modify or amend<br>• Changing beneficial interests<br>• Modify a power of appointment<br>• Change applicable law<br>A.R.S. § 14-10818.B |

# Appendix 6: Directed Trust and Trust Protector Statutes—Part 1

As of February 2019

| | UTC | Missouri | Kansas | Nebraska | Iowa | Arizona |
|---|---|---|---|---|---|---|
| **Prohibited Powers** | Not Specified | No power to modify a trust to:<br>• Remove a payback requirement in SNT<br>• Reduce or eliminate income interest of the income beneficiary of any of the following types of trusts: (a) trust qualifying for Marital deduction; (b) CRT; (c)GRAT; or (d) QSST<br>RSMO § 456.8-808.4 | Not Specified | Not Specified | Not Specified | May not:<br>• Add beneficial interest unless already a beneficiary<br>• Modify the beneficial interest of a governmental unit in SNT<br>A.R.S. § 14-10818.C |
| **Is the Directing Party a Fiduciary?** | Presumptively a fiduciary<br>UTC § 808(d) | Fiduciary<br>RSMO § 456.8-808.6(1) | Presumptively a fiduciary<br>KSA § 58a-808(d) | Presumptively a fiduciary unless a beneficiary<br>Neb. Rev. St. § 30-3873(d) | Presumptively a fiduciary unless a beneficiary<br>ICA § 633A.4207(3) | Unless trust instrument provides otherwise, presumptively a fiduciary unless a beneficiary<br>ARS § 14-10808.D<br>Unless otherwise provided, trust protector is not a trustee or fiduciary<br>ARS § 14-10818.D |
| **Directing Party Liability** | Required to act in good faith.<br>Liable for breach of fiduciary duty<br>UTC § 808(d) | Not liable for acts or omissions unless breach of duty, bad faith or reckless indifference<br>RSMO § 456.8-808.6(2) | Breach of fiduciary duty<br>KSA § 58a-808(d) | Breach of fiduciary duty<br>Neb. Rev. St. § 30-3873(d) | Breach of fiduciary duty.<br>ICA § 633A.4207(3) | Breach of a fiduciary duty.<br>ARS § 14-10808.D<br>A Trust Protector is not liable for acts or omissions<br>ARS § 14-10818.D |
| **Notes** | | Missouri refers exclusively to "Trust Protectors" | | | | Arizona has a separate statute for Trust Protectors: ARS § 14-10818 |

# Appendix 7: Directed Trust and Trust Protector Statutes—Part 2

As of February 2019

| | South Dakota | Illinois | Colorado | Minnesota | Texas |
|---|---|---|---|---|---|
| **Code Section** | SDCL Title 55-1b | 760 ILCS 5/16.3 | CRS §§ 15-16-801–15-16-809 | MSA § 501C.808 | Tex. Prop. Code § 114.0031 |
| **Trustee's Duty With Respect To The Directing Party** | No duty to review, evaluate, communicate, warn or apprise<br>SDCL § 55-1B-2 | No duty to monitor, review, inquire, investigate, recommend, evaluate, or warn<br>760 ILCS 5/16.3(f) | No duty to review or monitor the actions of a trust advisor<br>CRS § 15-16-805<br>Duty to keep a trust advisor reasonably informed<br>CRS § 15-16-806.1 | No duty to monitor, review, inquire, investigate, recommend, evaluate, or warn<br>MSA § 501C.808 subd. 6 | No duty to monitor, advise, consult, communicate or warn<br>Tex. Prop. Code § 114.0031(h) |
| **Trustee Liability For Directing Party's Actions** | Not liable for any of the following:<br>(1) compliance with direction;<br>(2) Failure to receive a prior authorization;<br>(3) gross negligence or willful misconduct, if required to assume the role of director.<br>SDCL § 55-1B-2<br>Not liable for any action upon direction.<br>SDCL § 55-1B-5 | Not liable for any action, inaction, consent, or failure to consent by a directing party, including but not limited to any of the following:<br>(1) if direction and acts in accordance with direction, not liable except for willful misconduct;<br>(2) if consent, not liable for failure to consent except for willful misconduct; or<br>(3) if required to assume the role of director, then same standards that applied to such director<br>760 ILCS 5/16.3(f) | If direction and acts in accordance with direction, not liable except for willful misconduct.<br>Not liable for trust advisor.<br>CRS § 15-16-807 | Not liable for any action, inaction, consent, or failure to consent by a directing party, including but not limited to, any of the following:<br>(1) if direction and acts in accordance with direction, not liable except for willful misconduct;<br>(2) if consent, not liable for failure to consent except for willful misconduct; or<br>(3) if required to assume the role of director, then willful misconduct<br>MSA § 501C.808 subd. 6 | Not liable for acts in accordance with the direction except in cases of willful misconduct<br>Tex. Prop. Code § 114.0031(f)<br>If consent, not liable for failure to consent except for willful misconduct or gross negligence<br>Tex. Prop. Code § 114.0031(g) |

# Appendix 7: Directed Trust and Trust Protector Statutes—Part 2

As of February 2019

| | South Dakota | Illinois | Colorado | Minnesota | Texas |
|---|---|---|---|---|---|
| **Directing Party's Powers Expressly Authorized** | As established by the governing instrument and may include:<br>• Powers of Trust Protector<br>SDCL § 55-1B-6<br>• Powers of Investment Trust Advisor<br>SDCL § 55-1B-10<br>• Powers of Distribution Trust Advisor<br>SDCL § 55-1B-11<br>• Powers of Family Advisor<br>SDCL § 55-1B-12 | Default powers:<br>• Powers of an Investment Trust Advisor<br>760 ILCS 5/16.3(b)<br>• Powers of a Distribution Trust Advisor<br>760 ILCS 5/16.3(c)<br>• Powers of a Trust Protector<br>760 ILCS 5/16.3(d) | As established by the governing instrument and may include:<br>• Exercise of a power normally performed by a trustee<br>• Direct investments<br>• Direct discretionary distributions<br>CRS § 15-16-803 | Default Powers:<br>• Powers of an Investment Trust Advisor<br>MSA § 501C.808 subd. 2<br>• Powers of a Distribution Trust Advisor<br>MSA § 501C.808 subd. 3<br>• Powers of a Trust Protector<br>MSA § 501C.808 subd. 4 | As established by the governing instrument and may include:<br>• Remove and appoint a trustee<br>• Modify or amend<br>• Modify a power of appointment<br>Tex. Prop. Code § 114.0031(d) |
| **Prohibited powers** | Not Specified | Not Specified | Not Specified | Not Specified | Not Specified |
| **Is the Directing Party a Fiduciary?** | Trust Protectors presumed not to be a fiduciary unless governing instrument provides otherwise (unless exercising authority of an investment trust advisor or a distribution trust advisor.<br>SDCL § 55-1B-1(2)<br>All other trust advisors are presumed to be a fiduciary, unless the governing instrument provides otherwise<br>SDCL § 55-1B-4 | Directing Party is a fiduciary, unless the governing instrument provides otherwise<br>760 ILCS 5/16.3(e) | Trust advisor is a fiduciary<br>CRS §§ 15-16-801; 15-16-802 | Directing Party is a fiduciary, unless the governing instrument provides otherwise<br>MSA § 501C.808 subd. 5 | Directing Party is a fiduciary, unless the governing instrument provides otherwise<br>Tex. Prop. Code § 114.0031(e) |
| **Directing Party's Liability** | Unless the governing instrument provides otherwise, no greater liability than a trustee<br>SDCL § 55-1B-1.1 | Unless the governing instrument provides otherwise, no greater liability than a trustee<br>760 ILCS 5/16.3(e) | Not Specified | Unless the governing instrument provides otherwise, no greater liability than a trustee<br>MSA § 501C.808 subd. 5 | Not Specified |
| **Notes** | | | Colorado's terminology is different. | | |