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WHO'S THE BOSS? FIDUCIARY LIABILITY AND DIRECTED TRUSTS

THE LEGAL HISTORY, INCONGRUOUS VARIATIONS, AND OUTER REACHES OF THE REAL ESTATE TRANSFER TAX

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WHO'S THE BOSS? FIDUCIARY LIABILITY AND DIRECTED TRUSTS

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Authors' Synopsis: "Directed Trusts"—trusts in which someone other than a trustee has a role in the administration—are becoming more and more commonplace. However, many states impose differing fiduciary standards on trustees and those third parties (so-called "trust directors").

This lack of uniformity leads to uncertainty and confusion about fiduciary liability, such as whether a trust director owes a fiduciary duty to the beneficiaries; whether a trustee can be absolved of liability if the trust director is a nonfiduciary; and whether the directed trust can be structured so that neither the trustee nor the trust director are accountable as fiduciaries.

These uncertainties will likely need to be addressed by our courts. In the meantime, practitioners must use their best efforts to interpret sometimes unclear statutory authority and consider the potential issues in drafting directed trusts and advising clients regarding their administration.

This Article will examine these issues, starting with an introduction of directed trusts, followed by a discussion of governing statutory law

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and model legislation, including the Uniform Directed Trust Act. This Article will then tackle the extent of liability faced by trust directors and trustees, respectively. Throughout the Article, we integrate important drafting considerations estate planners should take into account when preparing directed trusts. Of course, this Article does not focus solely on issues of interest to estate planners. The authors of this Article collectively practice in all areas of trust and estate law. Thus, this Article should also be of interest to those who practice in the areas of trust and estate administration and fiduciary litigation.

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I. INTRODUCTION

“Directed Trusts”—trusts in which someone other than a trustee has a role in the administration—are becoming more and more commonplace. Jurisdictions continue to adopt legislation governing them. Of course, with widespread adoption of such law comes varied legislative approaches. There is a lack of uniformity among the states such that different jurisdictions impose differing fiduciary standards on trustees and those third parties (so-called “trust directors”).

This lack of uniformity leads to uncertainty and confusion. When a trust director is added to the mix—who owes fiduciary duties to the beneficiaries? What if the trust director is a nonfiduciary and yet the trustee is absolved of liability? Can a directed trust be structured in a way that no one—not the trustee and not the trust director—will be accountable as a fiduciary? And if that is the case, are we really dealing with a trust at all?

These are questions that will likely need to be answered by our courts. In the meantime, practitioners must use their best efforts to interpret sometimes unclear statutory authority. But in drafting directed trusts and advising clients regarding their administration, they should consider these issues.

This Article will examine those issues. Part I of this Article will introduce the concept of directed trusts: What are they? What is a trust director? What power can be instilled in the trust director?

Part II will examine governing statutory law as well as the model legislation that has influenced the law in varied ways throughout the nation. In that regard, we will examine what the future may hold for directed trusts, including the Uniform Directed Trust Act, an entire model body of law that jurisdictions are rapidly adopting.

Parts III and IV will cover the crux of what this Article strives to tackle—the extent of liability faced by trust directors and trustees, respectively. Throughout the Article, we integrate important drafting considerations estate planners should take into account when preparing directed trusts. Of course, this Article is not focused solely on issues of interest to estate planners. The authors of this Article collectively practice in all areas of trust and estate law. Thus, this Article should also be of

interest to those who practice in the areas of trust and estate administration and fiduciary litigation.

II. INTRODUCTION TO DIRECTED TRUSTS

A “Directed Trust” is a trust under which a designated third-party decision maker, who is not the trustee, is assigned a role in the trust’s administration.¹

Trustees of traditional trusts are held to the highest fiduciary duties existing under the law.² Trustees and beneficiaries have a special relationship.³ Thus, a trustee faces heightened fiduciary obligations stricter than those imposed, for example, under the business judgment rule or other fiduciary law.⁴

Many forms of conduct permissible in a workaday world for those acting at arm’s length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the marketplace. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior.⁵

These fiduciary standards are applied with “uncompromising rigidity.”⁶ The trustee must act “at a level higher than [those] trodden by the crowd.”⁷

Among those many fiduciary obligations are the trustee’s duties of good faith, loyalty, and due care.⁸ The trustee must act as a prudent person in administering the trust.⁹ The trustee must exercise reasonable care, exercise skill, and act with caution in fulfilling all obligations.¹⁰

¹ See Nicole M. Vance, *Getting Closer to “Having It All” Directed Trusts: A Unique Direction for Trust Planning*, NEV. LAW., Nov. 2014, at 11, 12.

² See Timothy M. Ferges, *A Dichotomy of Fiduciary Duties: Which Hat Does a Trustee Wear While Managing the Trust’s Business?*, PROB. & PROP., July–Aug. 2018, at 34, 34.

³ See *id.*

⁴ See *id.* at 35.

⁵ *Meinhard v. Salmon*, 164 N.E. 545, 546 (N.Y. 1928).

⁶ *Wendt v. Fischer*, 154 N.E. 303, 304 (N.Y. 1926).

⁷ *Meinhard*, 164 N.E. at 546.

⁸ See GEORGE GLEASON BOGERT ET AL., *THE LAW OF TRUSTS AND TRUSTEES* § 541 (3d ed. 2022).

⁹ See *id.*

¹⁰ See *id.*

A trustee serves in several roles in fulfilling these obligations. Those roles include the roles of custodian, administrator, investment manager, distribution director, accountant, and other various roles.¹¹ Historically, trustees were ultimately responsible for performing each and every one of these roles and could not delegate their obligations to another.¹²

With new innovations developed by clever estate planners, trusteeship has become more complex over time. In that regard, attorneys practicing trust law have begun to realize that requiring trustees to fulfill all these various roles and prohibiting a settlor from shifting certain responsibilities on other individuals could be detrimental to beneficiaries. For example, the trustee might lack the requisite expertise to competently handle a trust administration task.

Moreover, there has been a reluctance on the part of certain individuals and entities to accept trusteeship where the trust holds special assets, such as shares of a closely held company or real estate. If the settlor desires to use a corporate trustee, for example, that corporate fiduciary may have concerns about its obligation to diversify trust investments or about claims that could be asserted regarding management of those special assets. The trustee could conceivably be held liable on a number of grounds for its management of such assets or, at minimum, be subjected to those claims.

Of equal concern has been the ability of the settlor to plan for the “protection” of the trust from unanticipated consequences resulting from future unknown events. If, for example, new tax laws result in unfavorable consequences to the trust as it is currently structured and administered, is anyone empowered to take any action that could protect the trust from those consequences?

As a result of these various concerns, in recent years, jurisdictions have been adopting legislation recognizing trusts in which a settlor can divide trust administration roles between the trustee and a third-party decision maker.

Put another way, the various administration roles and responsibilities of a trustee discussed above can be divided between different parties. Some legislation has also allowed settlors to assign entirely new non-administrative roles to third party decision makers that are not inherently part of a trustee’s role. All of these trusts are typically referred to as “Directed Trusts.”

¹¹ See Dennis I. Belcher & Jennifer A. Kosteva, *Slicing and Dicing Responsibilities and Duties of Trustees*, pt. 1 KOREN EST. & PERS. FIN. PLAN. UPDATE (2009).

¹² See BOGERT, *supra* note 8, § 138.

Those decision makers may hold varying titles, which might depend on the jurisdiction in which the trust was created. The title given to the third-party decision maker might also depend on the specific power instilled in the decision maker.¹³ These third-parties have been called: “Trust Protectors,” “Trust Advisers,” “Investment Advisers,” or “Distribution Directors,” among many other names.¹⁴ In the Uniform Directed Trust Act (“UDTA”), the Uniform Law Commission applies the general label “Trust Director” to refer to all such third-party decision makers.¹⁵

What can a Trust Director do? The simpler question may be—what can a Trust Director *not* do? Statutes and case law place few limits on roles or powers that can potentially be instilled in a Trust Director.

A Trust Director typically is granted one of two general types of powers: (a) a power of direction or (b) a power of protection.¹⁶ To the extent the third-party decision maker is assigned a designated aspect or aspects of the trust administration that would otherwise be handled by the trustee, he holds what is sometimes called a “Power of Direction.” In that case, responsibility for the administration of the trust may be split between multiple decision makers. To the extent the third-party decision maker is instead assigned an entirely different role that falls outside the scope of a trustee’s duties, he holds what is sometimes called a “Power of Protection.”¹⁷

A power of direction exists if the trust instrument grants the Trust Director the power to (a) direct, (b) consent, (c) disapprove, or (d) advise the trustee with respect to a specified aspect of the trust administration that would traditionally be handled by the trustee.¹⁸ Those aspects of the trust administration most commonly include investment decisions or distribu-

¹³ See John D. Morley & Robert H. Sitkoff, *Making Directed Trusts Work: The Uniform Directed Trust Act*, 44 AM. COLL. TR. & EST. COUNS. L.J., Winter 2019, at 3, 15–16.

¹⁴ See *id.*

¹⁵ See UNIF. DIRECTED TR. ACT § 2(9) (UNIF. L. COMM’N 2021).

¹⁶ See generally Morley & Sitkoff, *supra* note 13.

¹⁷ One might consider whether a trust director’s power alternatively really amounts to a veto power or some limited trustee role. In that case, conceptually, the trust director might hold authority that is more similar to that held by a co-trustee.

¹⁸ See Kathleen R. Sherby, *It’s a Whole New Ballgame – Trust Directors With Powers to Advise/Consent/Direct and With Powers of Protection*, AM. COLL. TR. & EST. COUNS. (June 2, 2016); see also UNIF. DIRECTED TR. ACT § 2(5).

tion decisions, but it may also include other traditional trust administration tasks.¹⁹

A power of direction with respect to investment decisions, for example, may be desired when the trust holds the so-called special assets discussed above.²⁰ In that case, a settlor can bifurcate the traditional investment authority such that the trust director can direct the trustee to hold those investments.²¹

A settlor can likewise empower a trust director to direct the trustee to make distributions.²² In that case, the settlor may select a distribution director with knowledge regarding the beneficiaries' unique individual needs such that the director would be in a position to make more informed decisions than the trustee. A director with a professional background in health care, for example, might be qualified to evaluate a beneficiary's medical needs. Or if a beneficiary has special needs, one might select a trust director familiar with therapeutics or the laws and regulations governing qualification for government benefits.

In many jurisdictions, a Trust Director with a power of direction (that is, a power over a traditional trustee role) is deemed a fiduciary.²³ That could be because the Trust Director exercises a role traditionally held by the trustee.²⁴ As discussed in further detail below, however, that is not the case in every jurisdiction.

The term "Trust Advisor"²⁵ often generally refers to a Trust Director holding a power of direction.²⁶ Depending on the specific role assigned to the Trust Adviser, however, she could instead be referred to as

¹⁹ See Michael A. Sneeringer & Jordan D. Veurink, *Directions to Trust Directors of Directed Trusts*, PROB. & PROP., May–June 2022, at 1, 2.

²⁰ See Richard C. Mills, *Rethinking 'A House Divided': The Concept and Practical Use of the Divided Trust*, 48 EST. PLAN. 08 at 8, 10–12 (2021).

²¹ See *id.*

²² See Sneeringer & Veurink, *supra* note 19, at 2.

²³ See Kimberly Stein, *Advisors, Protectors, Directors, Oh My: An Overview of the Uniform Directed Trust Act*, 28 OHIO PROB. L.J. 142, 142 (2018).

²⁴ See *id.* at 142–43.

²⁵ Note that the term "advisor" is spelled "adviser" in certain jurisdictions.

²⁶ See Richard C. Ausness, *When Is a Trust Protector a Fiduciary?*, 27 QUINNIPIAC PROB. L.J. 277, 291 (2014).

“Investment Adviser,” “Distribution Director,” or with another specific descriptive title.²⁷

In contrast to a power of direction, a power of protection exists if the trust instrument grants the Trust Director the power to engage in an action that is not a part of the trustee’s traditional role (that is, a power that the trustee would not otherwise have by virtue of her role as trustee).²⁸ For example, the Trust Director may be given the power to modify the trust, terminate the trust, remove or replace the trustee, change beneficial interests, modify the terms of a power of appointment under the instrument, modify other trust terms to correct mistakes or to reflect changes to the law governing trusts, move the situs or governing law of the trust, determine trustee compensation, and allocate between principal and income.²⁹ Those powers are not inherent in the role of a trustee.

These powers of protection are often granted with the idea that long-term flexibility is needed in the event unanticipated events occur warranting some change to the trust terms or to its administration. Those events may include changes to tax laws, laws governing trust administration, the economy, relationships among the settlor’s family, the ability of the trustee to serve, or other events.³⁰ The settlor may establish a role in which a Trust Director can “protect” the trust in the event of such an unexpected change.

In some jurisdictions, a Trust Director with a power of protection is not deemed a fiduciary because the Trust Director exercises a role that would not typically be exercised by the trustee.³¹

In many jurisdictions, a Trust Director holding a power of protection is specifically referred to as a “Trust Protector.”³²

The trustee of a directed trust is typically referred to as a “directed trustee” in that the trustee is required to follow, or consent to, the directions

²⁷ See William D. Lucius & Shirley B. Whitenack, *Directed Trusts: A Primer on the Bifurcation of Trust Powers, Duties, and Liabilities in Special Needs Planning*, 15 NAT’L ACAD. ELDER L. ATT’YS J. 71, 72 (2019).

²⁸ See Sherby, *supra* note 18; but see UNIF. DIRECTED TR. ACT § 2(5) (UNIF. L. COMM’N 2021).

²⁹ Going a step further, powers of protection could conceivably include the ability to remove rights of beneficiaries. For example, they might include the power to approve trustee accountings, construe trust terms, resolve disputes involving the trustee and beneficiaries, or absolve a trustee of liability.

³⁰ See Sherby, *supra* note 18.

³¹ See Stein, *supra* note 23, at 145.

³² See *id.*

or actions of the Trust Director, as specified in the trust instrument.³³ As a result, the idea is that the directed trustee might be absolved or insulated from liability to the extent the directed trustee follows the direction of the Trust Director.³⁴ That, however, may depend on the specific circumstances, the law of the specific jurisdiction, or, of course, the terms of the governing instrument.

III. LAWS GOVERNING DIRECTED TRUSTS

Although the usage of directed trusts is part of a growing trend in estate and trust practice, the concept of giving a third-party (someone other than the trustee) certain powers in a trust is not a new one.

Third-party oversight has been part of trust law in the United States for decades.³⁵ While the terminology has changed—and the words “directed trust” may not have always been used—the concept has deep roots.³⁶ For instance, New Jersey courts have recognized the authority of third-party decision makers with respect to the trust administration for at least sixty years.³⁷ To the extent a third-party decision maker was granted the power to direct traditional trust administration tasks, many courts determined those third-parties to be fiduciaries.³⁸

Despite that in some capacity the concept of directed trusts has been part of common law jurisprudence for quite some time, the inconsistency in state laws, the lack of a uniform vocabulary, and the uncertainty regarding fiduciary liability of these third-party actors have prompted the adoption of new law, such as the UDTA.³⁹

³³ *Id.*

³⁴ *See, e.g.*, UNIF. DIRECTED TR. ACT § 9 (UNIF. L. COMM’N 2021).

³⁵ *See, e.g.*, *Gathright’s Tr. v. Gaut*, 124 S.W.2d 782, 783–84 (Ky. 1939) (“The settlor may appoint an advisor to his trustee whose consent to certain acts may be prerequisite to the valid execution of parts of the trust.”).

³⁶ *See, e.g., id.*

³⁷ *See, e.g.*, *Com. Tr. Co. of N.J. v. Barnard*, 142 A.2d 865, 867 (N.J. 1958) (recognizing the authority of the settlor’s family members, who were not trustees, to direct the trustee’s investment of the trust assets).

³⁸ *See, e.g.*, *Lewis v. Hanson*, 128 A.2d 819, 828 (Del. 1957) (holding that a trust adviser with the power to consent to the trust’s investments “is a fiduciary, somewhat in the nature of a co-trustee, and is sometimes described as a quasi-trustee”).

³⁹ Directed Trusts have likewise been recognized and authorized under the Restatement of Trusts. *See* RESTATEMENT (FIRST) OF TR. § 185 cmt. a (AM. L. INST. 1935) (providing that “[t]he provisions of the trust instrument may give a person the power to control the action of the trustee in certain respects” and this person may be “a third person

As new statutory law is adopted, courts are issuing new decisions evaluating the scope of trust directors' authority. While limited, some case law supports expansive roles for trust directors. A Florida court, for example, upheld a trust protector's power to, in effect, end litigation.⁴⁰ The trust agreement allowed the trustee to appoint a trust protector to "correct ambiguities that might otherwise require court construction" or to "correct a drafting error that defeats my intent."⁴¹ The trust protector resolved a contested trust construction proceeding by modifying the governing law at issue.⁴² The Florida appellate court recognized that the trust protector had that power.⁴³

An Arizona appellate court arguably reached a different result.⁴⁴ The settlor directed the trustee, upon the settlor's death, to distribute \$200,000 to her hairdresser if her hairdresser survived her.⁴⁵ An arbitrator thereafter determined that the hairdresser, who did indeed survive the settlor, was entitled to that \$200,000 distribution.⁴⁶ The trust protector, however, subsequently modified the trust to remove the \$200,000 gift.⁴⁷ The appellate court disallowed the trust protector's modification, noting "the passage of time" and "the current posture" of the case after the arbitration ruling.⁴⁸ The court found the modification would amount to "an apparent effort to usurp the authority vested in [the arbitrator]."⁴⁹

A Louisiana appellate court upheld the trust agreement's appointment of a trust protector. In that case, the settlor named a trust protector who had the authority to remove the trustee.⁵⁰ The trustee challenged the

otherwise unconnected with the trust"); *see also* RESTATEMENT (SECOND) OF TR. § 185 (AM. L. INST. 1959); RESTATEMENT (THIRD) OF TR. § 75 (AM. L. INST. 2007) (recognizing the trust may "confer upon another a power to direct or otherwise control certain conduct of the trustee," in which case, the trustee generally owes a duty to comply with the exercise of such power).

⁴⁰ *See generally* *Minassian v. Rachins*, 152 So. 3d 719 (Fla. Dist. Ct. App. 2014).

⁴¹ *Id.* at 722.

⁴² *See id.*

⁴³ *See id.*

⁴⁴ *See Jordan v. Hubbard*, No. 1 CA-CV 16-0060, 2017 WL 1740206 at *6 (Ariz. Ct. App. May 4, 2017).

⁴⁵ *See id.* at *1.

⁴⁶ *See id.* at *2.

⁴⁷ *See id.*

⁴⁸ *Id.* at *6.

⁴⁹ *Id.*

⁵⁰ *See In re Eleanor Pierce (Marshall) Stevens Living Tr.*, 159 So. 3d 1101, 1103 (La. Ct. App. 2015).

appointment of the trust protector under the premise that no Louisiana law allowed for the role of a trust protector.⁵¹ The court, however, upheld the trust agreement's appointment of the trust protector because no Louisiana law precluded the role and found the role was not contrary to public policy.⁵² So in states without an explicit statute, or without clear enumeration of potential director powers, that law might present broad support for any trust director role that is not explicitly precluded by state law.

On the other hand, certain states have chosen to address the issue of directed trusts through statute. As outlined in more depth below, states have either adopted the Uniform Trust Code,⁵³ the Uniform Directed Trust Act,⁵⁴ enabling statutes, or off-the-rack statutes.

A. Uniform Trust Code

Given inconsistency in trust law among the states, in 2000, the Uniform Law Commission adopted the Uniform Trust Code (“UTC”) as a model statute.⁵⁵ In 2000, the UTC included section 808—Powers to Direct—which ratified the use of trust protectors and advisers.⁵⁶ Under that section, a director may have the “power to direct certain actions of the trustee.”⁵⁷ This suggests that any power held by a trustee could theoretically be instilled in a trust director.

The model statute further enumerates two specific powers of protection: “a power to direct the modification or termination of the trust.”⁵⁸ As recognized under the comments to UTC section 808, however, those specified powers may not constitute a comprehensive list of all available powers of protection.⁵⁹

The comments also make clear that a “veto” power is not a director power: “A trustee who administers a trust subject to a veto power occupies a position akin to that of a co-trustee and is responsible for taking

⁵¹ See *id.* at 1107.

⁵² See *id.* at 1109–11.

⁵³ See UNIF. TR. CODE prefatory note (UNIF. L. COMM’N 2000) (amended 2010).

⁵⁴ See UNIF. DIRECTED TR. ACT (UNIF. L. COMM’N 2021).

⁵⁵ See UNIF. TR. CODE prefatory note.

⁵⁶ See *id.* § 808.

⁵⁷ *Id.* § 808(b).

⁵⁸ *Id.* § 808(c).

⁵⁹ See *id.* § 808 cmt. (The use of the phrase “such broader powers” also suggests that Subsection (c) may actually include any power given to a “trust protector” and not just the enumerated powers to amend or terminate the trust.).

appropriate action if the third party's refusal to consent would result in a serious breach of trust."⁶⁰

Notably, the original model statute specifically imposed liability on a trust director holding power of direction.⁶¹ It provided that because a trust director is presumptively acting in a fiduciary capacity, the trust director is liable for breach of trust.⁶² But in 2010, that language was removed and replaced with the following legislative note: "A state that has enacted the Uniform Directed Trust Act (UDTA) should repeal section 808 and revise certain other provisions of the UTC as indicated in the legislative notes to the UDTA."⁶³

In some states UTC section 808 has been superseded by the Uniform Directed Trust Act—an entire model act containing multiple statutes detailing the governance and administration of directed trusts.⁶⁴ Other states—such as, for example, New Jersey—have adopted their own modified version of the UTC.⁶⁵ Yet other states have adopted their own directed trust statutes that are not based on any model act.⁶⁶

B. Uniform Directed Trust Act

In July 2017, the Uniform Directed Trust Act ("UDTA" or "Act") was adopted by the Uniform Law Commission.⁶⁷ The UDTA seems designed, in part, to address the uncertainty as to the extent of fiduciary obligations owed by the trust director and directed trustee.

The Act contains twenty sections that set forth the duties, powers, limitations, and liabilities of the powerholder and the directed trustee.⁶⁸

⁶⁰ *Id.* § 808 cmt.

⁶¹ *See id.*

⁶² *See id.*

⁶³ UNIF. TR. CODE § 808, Legis. Note; *see also* Lucius & Whitenack, *supra* note 27, at 79–80.

⁶⁴ *See* UNIF. DIRECTED TR. ACT (UNIF. L. COMM'N 2021).

⁶⁵ *See, e.g.*, N.J. STAT. ANN. § 3B:31-62. All state statutory citations in this Article refer to the current statute unless otherwise indicated.

⁶⁶ *See* NEV. REV. STAT. ANN. §§ 163.5536–59; S.D. CODIFIED LAWS § 55-1B-1.1; ALASKA STAT. §§ 13.36.370, 375.

⁶⁷ *See generally* UNIF. DIRECTED TR. ACT; *see also* *Directed Trust Act, Summary*, UNIFORM LAW COMMISSION (last visited Jan. 31, 2023), <https://www.uniformlaws.org/committees/community-home?CommunityKey=ca4d8a5a-55d7-4c43-b494-5f8858885dd8>.

⁶⁸ *See* UNIF. DIRECTED TR. ACT; *see also* UNIFORM LAW COMMISSION, *supra* note 67.

Since it was adopted, eighteen states have either introduced or enacted some version of the UDTA.⁶⁹

The UDTA's broad definition of "power of direction" includes "any 'power over a trust' to the extent the power is exercisable at a time [when] the power holder is not serving as a trustee."⁷⁰ Thus, it seems a "power of direction" under the UDTA would encompass both a power to direct a traditional trustee function, as well as a power to protect the trust by exercising some nontraditional role.⁷¹ The comments to Section 6 provide a nonexclusive list of director powers, encompassing everything from the power to direct investments to the power to "determine the capacity of [the] trustee."⁷²

The UDTA specifically excludes a number of potential powers as "powers of direction," including power of appointment, power to appoint or remove a trustee or trust director, power of a settlor over a trust the settlor retains the power to revoke, power of a beneficiary to modify a beneficial interest in the trust, and power over a trust held in a nonfiduciary capacity to achieve tax purposes.⁷³ The comments to section 5(b) explain that these excluded director powers were excluded from the definition because they are held in a nonfiduciary capacity, and not because they are powers some third-party to a trust should not hold.⁷⁴

The Act also lists exceptions—that is, powers that are not intended to be a "power of direction."⁷⁵ The person who holds the power is a "trust director,"⁷⁶ and the trustee that is subject to the power is called a "directed trustee."⁷⁷ The trust is called a "directed trust."⁷⁸ However, the Act applies

⁶⁹ See *Directed Trust Act, Map*, UNIFORM LAW COMMISSION (last visited Jan. 31, 2023), <https://www.uniformlaws.org/committees/community-home?CommunityKey=ca4d8a5a-55d7-4c43-b494-5f8858885dd8>.

⁷⁰ UNIF. DIRECTED TR. ACT § 2 cmt. (5).

⁷¹ See *id.* ("A power of direction may be structured as a power to direct the trustee in the exercise of the trustee's powers—for example, a power to direct the trustee in the investment or management of the trust property. A power of direction may also be structured as a power to act independently—for example, by amending the terms of a trust or releasing a trustee from liability.").

⁷² *Id.* § 6 cmt.

⁷³ See *id.* § 5(b).

⁷⁴ See *id.* § 5 cmt.

⁷⁵ *Id.* § 2 cmt. (5).

⁷⁶ *Id.* § 2(9).

⁷⁷ *Id.* § 2(3).

⁷⁸ *Id.* § 2(2).

to any trusts that function as a directed trust even if the trust uses other terminology—such as “trust protector” or “administrative trustee.”⁷⁹

“[U]nder the UDTA, the fiduciary responsibility for a power of direction attaches primarily to the [T]rust [D]irector who holds the power, rather than to the directed trustee who facilitates the director’s exercise of power.”⁸⁰

The heart of the UDTA are sections 8–9, which deal with the fiduciary duty of a directed trustee.⁸¹ Absent contrary language in the trust document, section 8 of the UDTA imposes on the trust director the same fiduciary duties in the exercise (or non-exercise) of a power of direction as a trustee in a like position and under similar circumstances.⁸²

Pursuant to section 9(a) of the UDTA, a directed trustee is required to comply with a power holder’s exercise (or nonexercise) of a power of direction and is not liable for doing so.⁸³ However, the UDTA does not require the directed trustee to follow the powerholder’s direction if the exercise (or nonexercise) of the power of direction requires the directed trustee to engage in willful misconduct.⁸⁴ In sum, in determining whether to follow a direction, a directed trustee must ensure that the direction does not cause the trustee to knowingly or intentionally engage in misconduct.⁸⁵ This is a departure from many jurisdictions in which a directed trustee is fully relieved from a duty or liability for complying with an action of a trust direction.

Both the power holder and the directed trustee are required to share information necessary to fulfill their duties as stated in section 10.⁸⁶ However, pursuant to section 11(a)(1)(A)-(B) of the UDTA, the directed trustee does not have a duty to monitor the power holder or to inform or advise the settlor or beneficiary concerning an instance in which the directed trustee may have acted differently than the power holder directed.⁸⁷

⁷⁹ *Id.* § 2 cmts. 3 & 9.

⁸⁰ Richard W. Nenno, *Directed Trusts: Making Them Work*, TAX MGMT. EST., GIFTS, & TR. J., Sept. 2020, at 1, 6.

⁸¹ *See* UNIF. DIRECTED TR. ACT §§ 8–9.

⁸² *See id.* § 8(2).

⁸³ *See id.* § 9(a).

⁸⁴ *See id.* § 9(b).

⁸⁵ *See id.* § 9.

⁸⁶ *See id.* § 10.

⁸⁷ *See id.* § 11(a)(1)(A)–(B).

In sum, it seems the aim of the UDTA is to provide some clarity—the trust director is indeed a fiduciary, but while the directed trustee is absolved of certain liability, the trustee still owes the beneficiaries certain minimal fiduciary obligations, such as the duty to act in good faith and not engage in willful misconduct.

C. Directed Trust Laws

1. Common Law

Directed trusts were first statutorily recognized in Delaware in 1986.⁸⁸ Since then, nearly every state has enacted statutory authority—with notable exceptions being California, New York, and Rhode Island (although New York and Rhode Island have introduced legislation to adopt the UDTA).⁸⁹ Each state also has its own body of trust law with varying levels of effectiveness for the bifurcation of duties and liability between directors and trustees. While the vast majority of states have either adopted the UTC, UDTA, or some variation of the same, there are a subset of states that have enacted more unique directed trust statutes. The statutes of those states—Alaska, Nevada, and South Dakota—offer greater protection to trustees seeking exculpation.

Those three states, as well as Delaware, are widely considered the most “trust friendly” states. They are therefore popular when it comes to selection of trust situs. The focus of these jurisdictions is often modernization and flexibility. They offer law supporting long-term trusts, decanting, privacy, and private trust companies. They impose no state income tax. Moreover, directed trusts in those states are either well supported by case law (in the case of Delaware) or robust statutes (in the case of Alaska, Nevada, and South Dakota).

Directed trusts statutes can be categorized in one of two categories—(a) those statutes that allow a settlor to appoint a *specific* type of trust director with predefined specific *statutory* authority versus (b) those that only allow a settlor to name a generic “trust director” but empowering the settlor to define—in the trust instrument—the authority granted to the director. In 2018, Professors John Morley and Robert H. Sitkoff defined these categories as “Off-the-Rack” and “Enabling” statutes, respectively.⁹⁰

⁸⁸ See DEL. CODE ANN. tit. 12, § 3313.

⁸⁹ See UNIFORM LAW COMMISSION, *supra* note 69; *Trust Code, Map*, UNIFORM LAW COMMISSION (last visited Dec. 8, 2022), <https://www.uniformlaws.org/committees/community-home?CommunityKey=193ff839-7955-4846-8f3c-ce74ac23938d>.

⁹⁰ See Morley & Sitkoff, *supra* note 13, at 13.

2. *Enabling Statutes*

Enabling statutes establish a single class of trust directors with no default power. Enabling statutes offer flexibility—the settlor can set forth in the instrument what powers are to be instilled in the trust director but need not employ terminology such as “trust protector” or “investment advisor” to instill that power in the trust director.⁹¹ Put another way, the settlor must specify the specific powers granted to each director. For example, Delaware’s enabling statute states,

Where 1 or more persons are given authority by the terms of a governing instrument to direct, consent to or disapprove a fiduciary’s actual or proposed investment decisions, distribution decisions or other decision of the fiduciary, such persons shall be considered to be advisers and fiduciaries when exercising such authority provided, however, that the governing instrument may provide that any such adviser (including a protector) shall act in a nonfiduciary capacity.⁹²

The UDTA likewise includes an enabling statute that does not establish specific categories of directors with predefined default powers (it only refers to the appointment of a generic “trust director”).

a. Delaware’s Directed Trust Statute

Delaware’s directed trusts statute, title 12, section 3313, (1) provides for investment powers, (2) provides for distribution powers, (3) provides for at least limited trust protector powers, (4) is silent on powers to limit beneficiaries’ rights to enforce their interests, and (5) is silent on veto and advisory powers. Section 3313 pertains to “advisers.”⁹³ This provision includes persons given authority “to direct, consent to or disapprove a fiduciary’s actual or proposed investment decisions, distribution decisions or other decision of the fiduciary”⁹⁴ The section also provides additional information about the powers of an advisor related to the “investment decision” and those of an advisor acting as a “protector.”⁹⁵

⁹¹ Morley & Sitkoff, *supra* note 13, at 13.

⁹² DEL. CODE ANN. tit. 12, § 3313(a).

⁹³ *Id.* § 3313.

⁹⁴ *Id.* § 3313(a).

⁹⁵ *Id.* § 3313(d), (f).

For an advisor with “investment decision” powers, the powers broadly encompass the following:

all of the trust’s investments (or, if applicable, to investments specified in the governing instrument), the retention, purchase, sale, exchange, tender or other transaction or decision affecting the ownership thereof or rights therein (including the powers to borrow and lend for investment purposes, provided, however, that the power to lend for investment purposes shall be considered an investment decision only with respect to loans other than those described in § 3325(19)b and c of this title), all management, control and voting powers related directly or indirectly to such investments (including, without limitation, nonpublicly traded investments), the selection of custodians or subcustodians other than the trustee, the selection and compensation of, and delegation to, investments advisers, managers or other investment providers, and with respect to nonpublicly traded investments, the valuation thereof, and an adviser with authority with respect to such decisions is an investment adviser.⁹⁶

For an advisor who is a protector, the powers broadly may include, but are not limited to, the following:

- (1) The power to remove and appoint trustees, advisers, trust committee members, and other protectors;
- (2) The power to modify or amend the governing instrument to achieve favorable tax status or to facilitate the efficient administration of the trust; and
- (3) The power to modify, expand, or restrict the terms of a power of appointment granted to a beneficiary by the governing instrument.⁹⁷

3. *Off-The-Rack Statutes*

“Off-The-Rack” statutes, on the other hand, describe specific categories of trust directors with statutorily defined powers afforded to each category. In other words, the statutes specifically differentiate between an “investment

⁹⁶ *Id.* § 3313(d).

⁹⁷ *Id.* § 3313(f).

advisor,” “distribution advisor,” and “trust protector”—each with a specific statutorily-defined specific power. Those statutory definitions and powers govern by default—the settlor can modify the power instilled in his or her trust director in the governing instrument.⁹⁸ But in the absence of such modification, if a settlor names an “investment advisor” in the trust instrument, that “investment advisor” will only possess the authority granted to an “investment advisor” under statutory law.⁹⁹

South Dakota, Nevada, and Alaska each adopted Off-the-Rack powers. Nevada and South Dakota each offer four categories of trust directors. Those categories include a “trust protector,” “distribution trust advisor,” and “investment trust advisor.”¹⁰⁰ Nevada’s statute also creates a “directing trust adviser,”¹⁰¹ while South Dakota creates a role for a “family advisor.”¹⁰² Alaska’s offers three categories of trust directors: “trustee advisor,” “trust protector,” and “co-trustees.”¹⁰³

a. South Dakota’s Directed Trusts Statute

South Dakota’s directed trusts statute (1) provides for investment powers, (2) provides for distribution powers, (3) provides for trust protector powers, (4) provides for veto and advisory powers, and (5) may allow powers to limit beneficiaries’ rights to enforce their interests.¹⁰⁴ South Dakota’s statute defines a number of roles—“trust advisor,” “trust protector,” “distribution trust advisor,” and “family advisor”—and enumerates the powers that a director with those roles may have.¹⁰⁵ Trust advisors can “direct, consent to, or disapprove a fiduciary’s investment or distribution decisions, or proposed investment or distribution decisions.”¹⁰⁶ The South Dakota statute further provides that an investment trust advisor has broad powers to direct the trustee with respect to investments, directly vote proxies for securities held in trust, hire

⁹⁸ See Morley & Sitkoff, *supra* note 13, at 10–12; see also Nenno, *supra* note 80, at 16.

⁹⁹ Morley & Sitkoff, *supra* note 13, at 12.

¹⁰⁰ NEV. REV. STAT. §§ 163.5536-47; S.D. CODIFIED LAWS § 55-1B-1(2)-(7).

¹⁰¹ NEV. REV. STAT. §§ 163.5536.

¹⁰² S.D. CODIFIED LAWS § 55-1B-1(10).

¹⁰³ ALASKA STAT. §§ 13.36.370, .375, .072.

¹⁰⁴ See S.D. CODIFIED LAWS § 55-1B-6.

¹⁰⁵ *Id.*

¹⁰⁶ *Id.* § 55-1B-4.

investment advisors, and direct the trustee with respect to the valuation of a trust asset.¹⁰⁷

Trust protectors can exercise a broad range of powers involving distributions, modifications to the trust including beneficial interests, and veto/advising powers. Specifically, a trust protector's powers may include the following:

- (1) Modify or amend the trust instrument to achieve favorable tax status or respond to changes in the Internal Revenue Code, state law, or the rulings and regulations thereunder;
 - (2) Increase or decrease the interests of any beneficiaries to the trust;
 - (3) Modify the terms of any power of appointment granted by the trust . . .;
 - (4) Remove and appoint a trustee, a fiduciary provided for in the governing trust instrument, trust advisor, investment committee member, or distribution committee member;
 - (5) Terminate the trust;
 - (6) Veto or direct trust distributions;
 - (7) Change situs or governing law of the trust, or both;
 - (8) Appoint a successor trust protector;
 - (9) Interpret terms of the trust instrument at the request of the trustee;
 - (10) Advise the trustee on matters concerning a beneficiary;
 - (11) Amend or modify the trust instrument to take advantage of laws governing restraints on alienation, distribution of trust property, or the administration of the trust . . .;
-

¹⁰⁷ See *id.* § 55-1B-10.

- (13) Add to the trust an individual beneficiary or beneficiaries from a class of individuals identified in the governing instrument¹⁰⁸

In addition to the listed powers, both a trust advisor or trust protector can have “some, none, or all of the rights, powers, privileges, benefits, immunities, or authorities available to a trustee under South Dakota law or under the governing instrument.”¹⁰⁹

Finally, South Dakota law allows for a “family trust advisor” whose powers can include:

- (1) Remove and appoint a trustee, a fiduciary provided for in the governing trust instrument, trust advisor, investment committee member, or distribution committee member;
- (2) Appoint a trust protector, or a family advisor;
- (3) Advise the trustee on matters concerning any beneficiary; receive trust accountings, investment reports, and other information from the trustee or to which a beneficiary is entitled; attend meetings [involving the trust] . . . ; and to consult with a fiduciary regarding both fiduciary and nonfiduciary matters or actions . . . ; or
- (4) Provide direction regarding notification of qualified beneficiaries¹¹⁰

b. Nevada’s Directed Trusts Statute

Nevada’s directed trusts statute (1) provides for investment powers, (2) provides for distribution powers, (3) provides for trust protector powers, (4) provides for at least some powers to limit beneficiaries’ rights to enforce their interests, and (5) largely excludes veto and advisory powers (except as noted below).¹¹¹ Nevada’s statute defines a “directing trust adviser” as a “trust adviser, trust protector or other person designated in the trust instrument who has the authority to give directives that must be followed by the fiduciary.”¹¹² Nevada’s statute is clear that a third party

¹⁰⁸ *Id.* § 55-1B-6.

¹⁰⁹ *Id.* § 55-1B-1.1.

¹¹⁰ *Id.* § 55-1B-12.

¹¹¹ See generally NEV. REV. STAT. ANN. § 163.553-557.

¹¹² NEV. REV. STAT. ANN. § 163.5536.

who merely gives recommendations, counsels, or advises is not contemplated as a “Directing Trust Advisor” for purposes of Nevada law.¹¹³

Nevada’s statute provides a broad set of nonexclusive powers that a trust protector may have:

- (a) Modify or amend the instrument to achieve a more favorable tax status or to respond to changes in federal or state law.
- (b) Modify or amend the instrument to take advantage of changes in the rule against perpetuities, restraints on alienation or other state laws restricting the terms of a trust, or the distribution of trust property or the administration of the trust.
- (c) Increase or decrease the interests of any beneficiary under the trust.
- (d) Modify the terms of any power of appointment granted by the trust, . . . [but not to] grant a beneficial interest to a person which was not specifically provided for under the trust instrument.
- (e) Remove and appoint a trustee, trust adviser, investment committee member or distribution committee member.
- (f) Terminate the trust.
- (g) Direct or veto trust distributions.
- (h) Change the location or governing law of the trust.
- (i) Appoint a successor trust protector or trust adviser.
- (j) Interpret terms of the instrument at the request of the trustee.
- (k) Advise the trustee on matters concerning a beneficiary (although it is difficult to understand how this squares with the prohibition on nonbinding advisors).
- (l) Review and approve a trustee’s reports or accounting.¹¹⁴

¹¹³ *Id.*

¹¹⁴ *Id.* § 163.5553.

Nevada's statute also delineates the powers an investment trust advisor and distribution trust advisor may have. An investment trust advisor's powers include directing the trustee "with respect to the retention, purchase, sale or encumbrance of trust property and the investment and reinvestment of principal and income of the trust," voting proxies, and selecting investment advisors.¹¹⁵ The powers of a distribution trust advisor include directing "the trustee with regard to all discretionary distributions to a beneficiary."¹¹⁶

c. Alaska's Directed Trusts Statute

Alaska's directed trusts statute provides little guidance on what powers a director may exercise but explicitly contemplates some trust protector powers and advisory powers. Alaska trust law provides for a trust protector with a number of nonexclusive identified powers:

- (1) remove and appoint a trustee;
- (2) modify or amend the trust instrument to achieve favorable tax status or to respond to changes in 26 U.S.C. (Internal Revenue Code) or state law, or the rulings and regulations under those laws;
- (3) increase or decrease the interests of any beneficiary to the trust; and
- (4) modify the terms of a power of appointment granted by the trust.¹¹⁷

Alaska law prohibits a trust protector from exercising the power to "grant a beneficial interest to an individual or a class of individuals unless the individual or class of individuals is specifically provided for under the trust instrument."¹¹⁸

Alaska also provides for a role of trust advisor "with regard to all or some of the matters relating to the property of the trust."¹¹⁹ However, the statute allows that an advisor may or may not provide mandatory recommendations to the trustee and the advisor and trustee liability are dependent on whether the trust provides that the advisor's directions are

¹¹⁵ *Id.* § 163.5557(2)(a)–(c).

¹¹⁶ *Id.* § 163.5557(3).

¹¹⁷ *See* ALASKA STAT. § 13.36.370(b).

¹¹⁸ *Id.* § 13.36.370(c).

¹¹⁹ *Id.* § 13.36.375(a).

mandatory.¹²⁰ Consequently, whether or not the powers are those of a director as contemplated by, for example, the UTC, depends on the terms of the trust.

4. Drafting Tips for Practitioners

If the settlor desires for different classes of directors (investment, distribution, or other), then utilizing the default definitions contained in off-the-rack statutes can provide specification that may have otherwise been overlooked or may be missing from a trust instrument. However, the opposite is also true—a power may be provided to a director under an off-the-rack statute that the settlor would not have otherwise instilled in the trust director. If operating in an off-the-rack jurisdiction, a drafter should review and become comfortable with the nuanced complexity of the off-the-rack statute’s default definitions.

The drafter should also be sure that it is clear who holds the final vote when investment and distribution decisions are placed in different hands; otherwise, the courts may have to decide. In *Shelton v. Tamposi*,¹²¹ the sole trustee (an individual) was in charge of distributions and investment directors (also individuals) were responsible for investments. The trustee contended that she could require the investment directors to sell illiquid investments to make funds available for distribution.¹²² The investment directors insisted she could not.¹²³ Affirming the lower court, the New Hampshire Supreme Court sided with the investment directors.¹²⁴

In addition, drafters should avoid including the phrase “reasonable compensation” for directors. It is too vague to be helpful. It is common for a beneficiary investment advisor to hire an outside investment manager and to serve without compensation, but be reimbursed for expenses, including counsel fees.

IV. LIABILITY OF THE DIRECTOR: IS THE TRUST DIRECTOR A FIDUCIARY AND WHAT IS THE EXTENT OF THE DIRECTOR’S LIABILITY?

In most jurisdictions, there is extensive common law addressing the fiduciary obligations of trustees that has been developed over the course

¹²⁰ See *id.* § 13.36.375(b).

¹²¹ 62 A.3d 741, 746 (N.H. 2013).

¹²² See *id.* at 747.

¹²³ See *id.* at 754.

¹²⁴ See *id.*

of more than a century. Those fiduciary obligations, however, may not always govern the Trust Director's conduct. The following questions must be considered when dealing with a directed trust—(1) is the Trust Director a fiduciary, and (2) to the extent Trust Director is not a fiduciary, how is the Trust Director's conduct to be evaluated?

On one hand, a settlor may intend for her Trust Director to be governed by a standard different than what governs her trustee. On the other hand, if the directed trustee is indeed absolved of liability when acting pursuant to direction of the Trust Director, who will be held accountable to the beneficiaries?

In evaluating the obligations and liability of a Trust Director, jurisdictions have taken varied approaches. Some jurisdictions have determined that a Trust Director, in exercising his or her power, is liable as a fiduciary just as a trustee would be held liable. Other jurisdictions have held the extent of such liability may depend on the specific power instilled in the Trust Director. In yet other jurisdictions, the issue is unsettled.

A. Jurisdictions That Have Determined the Trust Director is a Fiduciary

Some jurisdictions seem to have definitively determined that all Trust Directors are fiduciaries.¹²⁵ That would presumably mean that in directing the trustee to exercise the trustee's authority to invest trust assets, make distributions, or exercise some other trustee role (that is, in exercising a "power of direction"), the Trust Director must fulfill fiduciary obligations of due care, loyalty, and good faith, as well as all other duties a trustee owes. That would likewise presumably mean a Trust Director who exercises power not inherently part of a trustee's role (a so-called "power of protection") must likewise fulfill fiduciary obligations in exercising such power (for example, in exercising the power to modify the trust, remove a trustee, or fulfill some other nontrustee role).

That would also presumably mean a Trust Director who does not fulfill those fiduciary obligations may be held liable for breach of fiduciary duty.

¹²⁵ See, e.g., IDAHO CODE ANN. § 15-7-501(1)(c) (providing that a "Fiduciary" includes a "trust advisor or a trust protector, who is acting in a fiduciary capacity for any person, trust or estate."); TENN. CODE ANN. § 35-15-808(e) (providing that a "trust advisor" or "trust protector" is a fiduciary); WYO. STAT. ANN. §§ 4-10-711, -713 (providing that "trust advisors" and "trust protectors" are "fiduciaries to the extent of the powers, duties and discretions granted to them under the terms of the trust instrument").

B. Jurisdictions in Which the Specific Power or Authority Determines Whether the Trust Director is a Fiduciary

Other jurisdictions vary the fiduciary role depending on the specific power the Trust Director holds. For example, some jurisdictions differentiate between Trust Directors holding powers of direction from those Trust Directors holding powers of protection.¹²⁶ It seems that such jurisdictions have determined that a Trust Director who does not direct or exercise a trustee role should not be held to the same fiduciary standard as a trustee.

Other jurisdictions seem to have determined that power to direct only certain trustee roles warrants imposition of fiduciary obligations.¹²⁷

This all raises an important question—if the Trust Director is not acting in a fiduciary capacity, what limits the Trust Director’s conduct and are there any repercussions for his actions? For example, one might expect that a Trust Director must, at minimum, act within the scope of authority granted to him under the trust instrument. Who is accountable to the beneficiary if (a) the Trust Director is not a “fiduciary” and, at the same time, (b) the directed trustee is absolved of liability for following the direction of the Trust Director? It would seem the beneficiary must have some recourse under the law. As the legislation governing directed trusts continues to mature, those are issues one would certainly expect our courts to encounter.

C. Jurisdictions Where the Law is Unsettled

There are yet other jurisdictions where the Trust Director’s status as a fiduciary or nonfiduciary is entirely unclear—either because the governing

¹²⁶ See, e.g., ARIZ. REV. STAT. ANN. §§ 14-10808, -10818 (providing that a Trust Director who “holds a power to direct is presumptively a fiduciary . . . and liable for breach of a fiduciary duty,” but “except to the extent otherwise provided by the trust instrument, a trust protector is not a trustee or fiduciary and is not liable or accountable as a trustee or fiduciary because of an act or omission of the trust protector when performing or failing to perform the duties of a trust protector under the trust instrument”); ALASKA STAT. §§ 13.36.370(d)–.375(d) (providing that a “trust advisor” is “liable to the beneficiaries as a fiduciary,” but, “[s]ubject to the terms of the trust instrument, a trust protector is not liable or accountable as a trustee or fiduciary because of an act or omission of the trust protector taken when performing the function of a trust protector under the trust instrument.”).

¹²⁷ See, e.g., S.D. CODIFIED LAWS § 55-1B-1 (providing that a Trust Director with the specific power to direct investments or distributions is generally a fiduciary, but noting a trust protector “may not be considered to be acting in a fiduciary capacity except to the extent the governing instrument provides otherwise.”); N.J. STAT. ANN. § 3B:31-62 (providing that a Trust Director with the specific power to direct investments is a fiduciary).

statute does not specify whether the Trust Director is deemed a fiduciary, or there simply is no case law addressing the issue.

For example, New Jersey recently adopted a modified version of the directed trusts statute found under the Uniform Trust Code.¹²⁸ New Jersey adopted a statute confirming a Trust Director holding power to direct investments serves as a fiduciary.¹²⁹

With respect to all other Trust Director roles, New Jersey adopted Section 808(d) of the Uniform Trust Code, but modified it. New Jersey deleted that model statute's reference to the Trust Director's role being "presumptively a fiduciary" and to the Trust Director's liability for "breach of fiduciary duty."¹³⁰ Nonetheless, New Jersey retained the UTC's limitation that a trustee cannot act in accordance with a Trust Director's written exercise of the Trust Director's power if "the trustee knows the attempted exercise would constitute a breach of a fiduciary duty that the person holding the power owes to the beneficiaries of the trust."¹³¹

So while the New Jersey legislature deleted references to a fiduciary role, it retained UTC language addressing a Trust Director's breach of fiduciary duty. That retained language could be construed to suggest a Trust Director does, in fact, owe fiduciary obligations. This is, however, unclear. There are currently no reported decisions in New Jersey interpreting this statute, so New Jersey law is unsettled on this issue.

Courts in other jurisdictions are beginning to examine this issue, but there still may be uncertainty.¹³²

D. Ability to Override the Governing Default Law

It may be the case that the governing law only applies by default. For example, the governing law might provide that a Trust Director is generally deemed a fiduciary but that the settlor can opt out of that default

¹²⁸ See N.J. STAT. ANN. § 3B:31-61(d).

¹²⁹ See *id.*

¹³⁰ *Id.*

¹³¹ *Id.* § 3B:31-61(b).

¹³² See, e.g., *Robert T. McLean Irrevocable Tr. v. Ponder*, 283 S.W.3d 786, 787 (Mo. Ct. App. 2009) (finding genuine issues of material fact regarding extent of Trust Director's fiduciary duties despite that the Trust Director holding a power of protection was "presumptively a fiduciary" under governing Missouri statute and the trust instrument provided he acted as a fiduciary).

law and dictate in the trust instrument that the Trust Director acts in only a nonfiduciary capacity.¹³³

Other jurisdictions might allow some ability to opt out of default law, subject to certain restrictions. As set forth above, South Dakota, for example, provides that as a general matter, Trust Directors with power to direct investments or distributions are considered “fiduciaries when exercising such authority.”¹³⁴ Nonetheless, in South Dakota, so long as more than one Trust Director serves and at least one Trust Director is a fiduciary, the governing instrument may provide that the other Trust Director is “not acting in a fiduciary capacity.”¹³⁵

E. Approach Under the Uniform Trust Act

The UDTA addresses many difficult questions that have become more common in light of the rise of directed trusts. In particular, it addresses the allocation of fiduciary responsibility between the trust director and the directed trustee.

Section 8 of the UDTA provides that a Trust Director owes the same fiduciary duty and is subject to the same fiduciary liability in the exercise or nonexercise of a power as a trustee would owe were the trustee to hold that power.¹³⁶ In other words, as a default rule, the UDTA provides that a Trust Director is generally deemed to serve in a fiduciary capacity.

This presumably means the Trust Director, in directing the trustee to take some action or in exercising some power of protection, is subject to the same standards of performance as trustees—in other words the Trust Director owes the beneficiaries due care, loyalty, and all other fiduciary duties that would be owed by the trustee. Nonetheless, the trust terms can vary that default fiduciary duty or liability of the Trust Director to the same extent that the trust terms can vary the fiduciary duty or liability of a trustee.¹³⁷

¹³³ See, e.g., DEL. CODE ANN. tit. 12, § 3313(a) (providing all Trust Directors “shall be considered to be advisers and fiduciaries when exercising [their] authority provided, however, that the governing instrument may provide that any such adviser (including a protector) shall act in a nonfiduciary capacity.”).

¹³⁴ S.D. CODIFIED LAWS § 55-1B-4.

¹³⁵ *Id.*

¹³⁶ See UNIF. DIRECTED TR. ACT § 8 (UNIF. L. COMM’N 2021).

¹³⁷ See *id.* § 8(a)(2).

F. Drafting Tips for Practitioners

In some states, when a person is granted the ability to direct, consent to, or disapprove a trustee's decisions, such person will, by default, be deemed a fiduciary. Nonetheless, statutory authority in some of these states indicates the trust instrument may grant such powers in a nonfiduciary capacity. To avoid disputes or litigation, drafters should explicitly define the extent of a trust director's liability in the trust instrument. In other words, drafters should explicitly set forth whether a director is acting in a fiduciary or non-fiduciary capacity.

The trust instrument should further require the director to accept appointment in writing to ensure the director is able and willing to act and has indeed accepted his or her appointment. The trust instrument should then establish a clear procedure that can be used to confirm that directions have been given and received, such as, for example, a requirement that the director provide written directions transmitted to the trustee in a specified manner.

V. LIABILITY OF THE TRUSTEE: IS THE DUTY TO FOLLOW THE DIRECTOR ABSOLUTE?

In addition to the extent of the trust director's liability and responsibility, one must consider how the trustee's fiduciary duties are impacted when administering a directed trust. The liability of a directed trustee will always depend on the specific governing law. For example, one would consider whether the state has enacted the UDTA, the UTC, or some other statutory authority. Existing common law should likewise always be considered.

A. No Liability Standard

According to the UDTA drafting committee, the policy rationale for no duty statutes is that duty should follow power. If a director has the exclusive authority to exercise a power of direction, then the director should be the exclusive bearer of fiduciary duty in the exercise or non-exercise of that power.¹³⁸ Placing the exclusive duty on a director does not diminish the total duty owed to a beneficiary because a settlor of a directed trust could have chosen to make the Trust Director the sole trustee instead. Thus, on greater-includes-the-lesser reasoning, a settlor who could have named a Trust Director to serve instead as a trustee should also be able to give the Trust Director the duties of the trustee. Under the "no duty"

¹³⁸ See *id.* § 8 cmt.

statutes, a beneficiary's only recourse for misconduct by the Trust Director is an action against the director for breach of the director's fiduciary duty to the beneficiary.¹³⁹

South Dakota, Nevada, and Alaska, for example, have adopted a "no liability" standard for directed trustees. Under South Dakota's directed trusts statute, for example, "[a]n excluded fiduciary is not liable, either individually or as a fiduciary, for . . . any loss that results from compliance with a direction of the trust advisor, including any loss from the trust advisor breaching fiduciary responsibilities or acting beyond the trust advisor's scope of authority."¹⁴⁰ An Excluded Fiduciary is "any fiduciary excluded from exercising certain powers under the instrument which powers may be exercised by the [settlor], custodial account owner, trust advisor, trust protector, trust committee, or other persons designated in the instrument."¹⁴¹

Likewise, under Nevada's directed trusts statute, "[a] directed fiduciary is not liable, individually or as a fiduciary for any loss which results from: (a) Complying with a direction of a directing trust adviser, whether the direction is to act or to not act"¹⁴²

Under Alaska's directed trusts statute, "the trustee who, by the terms of the trust instrument, is required to follow the directions of the advisor is not liable, individually or as a fiduciary, to a beneficiary for a consequence of the trustee's compliance with the advisor's directions, regardless of the information available to the trustee"¹⁴³

B. Willful Misconduct Standard

In the other category, there are states, including Delaware, Illinois, Texas, and Virginia, in which a directed trustee is *generally* not liable for complying with the direction of a Trust Director. In those states, however, the directed trustee may still be held liable if doing so would constitute "willful" or "intentional" misconduct.¹⁴⁴

The policy rationale under those statutes is that because a trustee stands at the center of a trust, the trustee must bear at least *some* duty, even if the trustee is acting under the direction of a director. Although the settlor

¹³⁹ See *id.* § 9(b) cmt.

¹⁴⁰ S.D. CODIFIED LAWS § 55-1B-2 (emphasis added).

¹⁴¹ *Id.* § 55-1B-1.

¹⁴² NEV. REV. STAT. § 163.5549 (emphasis added).

¹⁴³ ALASKA STAT. § 13.36.375(c) (emphasis added).

¹⁴⁴ UNIF. DIRECTED TR. ACT § 9(b) cmt.

could have made the Trust Director the sole trustee, the settlor did not actually do so—and under traditional understandings of trust law, a trustee must always be accountable to a beneficiary in some way.¹⁴⁵

The states in this group recognize, however, that in order to facilitate the settlor's intent that the Trust Director—rather than the directed trustee—be the primary or even sole decisionmaker, reducing the trustee's duty is appropriate to the extent authority is subject to direction. Accordingly, under these statutes a beneficiary's main recourse for misconduct by the Trust Director is an action against the director himself for breach of the director's fiduciary duty to the beneficiary.¹⁴⁶

The beneficiary also has recourse against the trustee, but only if the trustee's compliance with the director's exercise or nonexercise of the director's powers amounted to “willful misconduct” by the trustee. This approach, in effect, increases the total fiduciary duties owed to a beneficiary. All of the usual duties of trusteeship are preserved in the Trust Director, but in addition the directed trustee owes a duty to avoid willful misconduct.¹⁴⁷

This approach can be observed, for example, in Delaware. Under Delaware's statute,

[i]f a governing instrument provides that a fiduciary is to follow the direction of an adviser, and the fiduciary acts in accordance with such a direction, then except in cases of wilful misconduct on the part of the fiduciary so directed, the fiduciary shall not be liable for any loss resulting directly or indirectly from any such act.¹⁴⁸

Moreover,

[i]f a governing instrument provides that a fiduciary is to make decisions with the consent of an adviser, then except in cases of wilful misconduct or gross negligence on the part of the fiduciary, the fiduciary shall not be liable for any loss resulting directly or indirectly from any act taken or omitted as a result of such adviser's objection to such

¹⁴⁵ *See id.*

¹⁴⁶ *See id.*

¹⁴⁷ *See id.*

¹⁴⁸ DEL. CODE ANN. tit. 12, § 3313(b).

act or failure to provide such consent after having been requested to do so by the fiduciary.¹⁴⁹

Most states that have adopted this standard have not defined what amounts to “willful misconduct.” Therefore, one must examine case law. In the Delaware case of *Duemler v. Wilmington Trust Co.*,¹⁵⁰ for example, a sophisticated investment advisor was given the express power to direct the corporate trustee with respect to all investments.¹⁵¹ The corporate trustee sent the investment advisor a prospectus relating to certain investments, but the advisor was on vacation and, thus, took no action.¹⁵² The investments—which were in the prospectus—then declined in value, and the advisor sued the trustee alleging that the trustee breached its fiduciary duty by not providing the advisor with timely financial information.¹⁵³ Applying Delaware law, the court held that a directed trustee is not liable for the actions or inactions of a Trust Director if the trustee does not engage in willful misconduct.¹⁵⁴ The court explained that if a trustee were liable for failure to provide information, that would undermine Delaware’s directed trusts statute.¹⁵⁵

The Delaware Court of Chancery reached a similar result *In re Juan Carlos Fischberg Family Trust*,¹⁵⁶ where the court found there was no liability on the part of a corporate trustee for failing to follow the direction of a trust protector.¹⁵⁷ In *Fischberg*, the trust protector had directed the corporate trustee to distribute the trust assets to an offshore account for the trust beneficiary (who was the settlor’s wife).¹⁵⁸ Both the settlor and his wife were facing indictment by the State of New Jersey for healthcare fraud, and the funds in the trust were alleged to be proceeds from criminal

¹⁴⁹ *Id.* § 3313(c).

¹⁵⁰ No. 20033 NC, 2004 Del. Ch. LEXIS 478 (Del. Ch. Oct. 28, 2004).

¹⁵¹ *See id.* at *4–5.

¹⁵² *See id.* at *5–6.

¹⁵³ *See id.* at *3.

¹⁵⁴ *See id.* at *2.

¹⁵⁵ *See id.*; Nenno, *supra* note 80, at 23 (summarizing *Duemler*); *see also* PETER S. GORDON & MICHAEL M. GORDON, DIRECTED TRUSTS: SLICING AND DICING TRUSTEE’S DUTIES AND RESPONSIBILITIES 12 (Mid-Atlantic Fellows Inst. Nov. 2019); Todd A. Flubacher, *Directed Trusts: Panacea or Plague?*, NAEPC J. EST. & TAX PLAN., Sept. 2015, at 1–2.

¹⁵⁶ C.A. No. 2527-N, 2007 Del. Ch. LEXIS 330 (Del. Ch. Feb. 23, 2007).

¹⁵⁷ *See id.*; *see also* GORDON, *supra* note 155, at 19 (summarizing *Fischberg*).

¹⁵⁸ *See* GORDON, *supra* note 155, at 19.

enterprises.¹⁵⁹ The corporate trustee did not follow the trust protector's directions and instead filed a petition for instruction with the Court of Chancery.¹⁶⁰

C. Drafting Tips for Practitioners

Absent a settlor's explicit direction to the contrary, estate planners should consider including a "willful misconduct" standard when drafting in a "no liability" jurisdiction. Under a literal reading of no liability statutes, such as those in Alaska, Nevada, and South Dakota, one could argue a directed trustee may never be liable for complying with a director's direction, even if the exercise would constitute a breach of the director's fiduciary duty and even if the trustee is aware of the director's breach.

For example, in "no liability" jurisdictions, if a director has a power to direct the sale of trust property and the director orders the trustee to sell property to the director's children at a reduced price, the trustee may face no liability, even if the trustee knows that such sale would constitute a breach of the director's duty.¹⁶¹

No liability jurisdictions offer some flexibility—the settlor can adjust the standard as he or she intends. Therefore, inclusion of a "willful misconduct" standard establishes some certainty—a beneficiary would have some defined recourse for misconduct of a trustee. This may be particularly important in instances where the trust director is serving in a nonfiduciary capacity.

D. Duty to Inform

While guidance in most jurisdictions is limited, a directed trustee generally retains the duty to inform beneficiaries about the administration of the trust. However, the directed trustee may not specifically have a duty to warn them regarding ill-advised action of the trust director. On the other hand, to the extent a director *is* a fiduciary, then the director would presumably be responsible for fulfilling all fiduciary duties, including the duty to inform.

Section 808 of the UTC does not address a trustee's duty to inform.¹⁶² However, section 813 of the UTC governs a trustee's general duty to

¹⁵⁹ See *id.*

¹⁶⁰ See *id.*

¹⁶¹ See Morley & Sitkoff, *supra* note 13, at 40.

¹⁶² See UNIF. TR. CODE § 808 (UNIF. L. COMM'N 2003).

inform.¹⁶³ It provides that “[a] trustee shall keep the qualified beneficiaries of the trust reasonably informed about the administration of the trust and of the material facts necessary for them to protect their interests.”¹⁶⁴ Arguably, this means that a trustee has a duty to provide beneficiaries with information about the actions a director has taken.

Under the UDTA, a trust director with fiduciary duties can step into the role of trustee.¹⁶⁵ This means he must inform beneficiaries with respect to his exercise of his powers. The comments to section 10 of the UDTA lay out the framework for the duty of disclosure to beneficiaries:

The duty of a trust director to disclose information to a beneficiary is governed by Section 8, which prescribes the fiduciary duties of a trust director, subject to Section 11. The duty of a trustee to disclose information to a beneficiary is governed by the background law of an enacting state under Section 4 as modified by Section 11, which limits a directed trustee’s duty to inform a beneficiary about the actions of a trust director.¹⁶⁶

Under section 8 of the UDTA, “a trust director has the same fiduciary duty and liability in the exercise or nonexercise of the power.”¹⁶⁷ Thus, section 8 of the UDTA gives a director the same duty to inform a beneficiary to a director as a trustee would have.¹⁶⁸

Section 11 of the UDTA places explicit limits on the duty to inform. Under section 11, “unless the terms of a trust provide otherwise: (1) a trustee does *not* have a duty to: (A) monitor a trust director; or (B) inform or give advice to a settlor, beneficiary, trustee, or trust director concerning an instance in which the trustee might have acted differently than the director” and vice versa.¹⁶⁹ The comments to section 11 further explain that:

this section does not relieve a trustee of its ordinary duties to disclose, report, or account under otherwise applicable law such as under Uniform Trust Code § 813 (2004) or

¹⁶³ See *id.* § 813.

¹⁶⁴ *Id.* § 813(a).

¹⁶⁵ UNIF. DIRECTED TR. ACT §§ 8, 10.

¹⁶⁶ *Id.* § 10 cmt.

¹⁶⁷ *Id.* § 8(a)(1).

¹⁶⁸ See *id.*

¹⁶⁹ *Id.* § 11(a)(1).

Restatement (Third) of Trusts § 82 (2007). The same is true for a trust director, on whom Section 8(a) imposes the fiduciary duties of a trustee.¹⁷⁰

For example, if a trust director has a power to direct investments, this section would relieve a directed trustee of any duty to advise a beneficiary about the risks of the director's decision to concentrate the investment portfolio. The trustee would remain under a duty, however, to make periodic reports or accountings to the beneficiary and to answer reasonable inquiries by the beneficiary about the administration of the trust to the extent required by otherwise applicable law.

Delaware law does not impose on a trust director any duty to inform. Moreover, Delaware law, to some degree, limits a directed trustee's duty to inform. Under Delaware law, a directed trustee has no duty to:

- (1) Monitor the conduct of the adviser;
- (2) Provide advice to the adviser or consult with the adviser; or
- (3) Communicate with or warn or apprise any beneficiary or third party concerning instances in which the fiduciary would or might have exercised the fiduciary's own discretion in a manner different from the manner directed by the adviser.¹⁷¹

Section 3313(e) suggests that a trustee may have a duty to "report[] actions taken at the advisor's direction," but clearly excludes warning the beneficiaries that a director's actions may be ill-advised.¹⁷²

South Dakota, Nevada, and Alaska are similar to the Uniform Trust Code in that any reference to the duty to inform in their trust codes applies to all trustees. No statute eliminates or modifies that duty in the context of directed trusts.

The Virginia case of *Rollins v. Branch Banking & Trust Co. of Virginia*¹⁷³ examined the duty to inform in the context of a directed trust where the governing statute was silent regarding the trustee's duty to warn the beneficiaries.¹⁷⁴

¹⁷⁰ *Id.* § 11 cmt.

¹⁷¹ DEL. CODE ANN. tit. 12, § 3313(e).

¹⁷² *Id.*

¹⁷³ 56 Va. Cir. 147 (Va. Cir. Ct. 2001).

¹⁷⁴ *See id.*

The Virginia court held that a directed trustee was not liable for a \$25 million loss caused by retention of stock directed by the beneficiaries.¹⁷⁵ Under the trust terms, the beneficiaries (who also served as trust directors) were empowered to direct the trustee as to all investment decisions.¹⁷⁶ Nonetheless, the court would not dismiss the beneficiaries' claim that the trustee breached a duty to warn them about the deteriorating condition of trust investments.¹⁷⁷ Instead, the court observed, "the trustee has a duty to fully inform beneficiaries of all facts relevant to the subject matter of the trust which come into the trustee's knowledge and which are material for the beneficiary to know for the protection of his interests."¹⁷⁸ While the case ultimately settled, the Virginia legislature subsequently amended its directed trust statute to relieve a directed trustee from a duty to warn.¹⁷⁹

Under the UTC and the trust codes of most states, a trustee who fulfills his duty to inform receives the benefit of a shortened limitation period to the extent a beneficiary would challenge the trustee's disclosed actions.¹⁸⁰ Tennessee's enactment of the UTC includes an interesting expansion of this limitation period to include trust directors:

(a) A beneficiary, trustee, trust advisor, or trust protector shall not commence a proceeding against a trustee, former trustee, trust advisor, or trust protector for breach of trust more than one (1) year after the earlier of:

(1) The date the beneficiary, trustee, trust advisor, or trust protector or a representative of the beneficiary, trustee, trust advisor, or trust protector was sent information that adequately disclosed facts indicating the existence of a potential claim for breach of trust; or

(2) The date the beneficiary, trustee, trust advisor, or trust protector or a representative of the beneficiary, trustee, trust advisor, or trust protector possessed actual

¹⁷⁵ See *id.*

¹⁷⁶ See *id.*

¹⁷⁷ See *id.*

¹⁷⁸ *Id.*

¹⁷⁹ See VA. CODE ANN. § 64.2-1416(A).

¹⁸⁰ See UNIF. TR. CODE § 1005 (UNIF. L. COMM'N 2003).

knowledge of facts indicating the existence of a potential claim for breach of trust.¹⁸¹

Tennessee's spin on the UTC is unique. But it is a reminder that a trustee's—or a director's—best defense to a claim of breach of fiduciary duty is full disclosure to beneficiaries.

E. Drafting Tips for Practitioners

A practitioner should include language in the governing instrument requiring the director and directed trustee to share information. For example, the directed trustee must often account for trust assets. A director who selects or manages trust investments should be required to provide statements, information, and values upon the trustee's request. Delaware's statute includes effective language for information sharing:

Except as otherwise provided in a governing instrument, each trust fiduciary (including trustees, advisers, protectors, and other fiduciaries), and each trust nonfiduciary, has a duty upon request to keep all of the fiduciaries and nonfiduciaries for the trust reasonably informed about the administration of the trust with respect to any specific duty or function being performed by such fiduciary or nonfiduciary to the extent that providing such information to the other fiduciaries and nonfiduciaries is reasonably necessary for the other fiduciaries and nonfiduciaries to perform their duties¹⁸²

VI. CONCLUSION

With the emergence of directed trusts nationwide, the law governing trust administration has become far more complex and uncertain. The Uniform Law Commission strives to bring uniformity and certainty—particularly through the UDTA—but governing law overall remains underdeveloped and inconsistent.

If not clearly addressed in the governing instrument, one can foresee future disputes over the fiduciary, or nonfiduciary, obligations and liability that trust directors and directed trustees may, or may not, face.

Estate planners should make note of these issues while drafting directed trusts. Estate administration counsel and fiduciary litigators should bear

¹⁸¹ TENN. CODE ANN. § 35-15-1005(a).

¹⁸² DEL. CODE ANN. tit. 12, § 3317.

in mind the role of the directed trustee versus the role of the trust director and those varying duties and liabilities they each may, or may not, hold. Those who represent trust beneficiaries likewise must understand the responsibilities and liabilities of those responsible for administering their directed trusts.

In short, these are important issues that should be evaluated and considered by all trust practitioners.