

By **Charles E. Rounds, Jr.**

The Uniform Directed Trust Act

Context, content and critique

The trust relationship is a creature of equity, not statute. So is the office of trust protector or trust director. In 2017, the National Conference of Commissioners on Uniform State Laws approved the Uniform Directed Trust Act (UDTA). Let's review general equity doctrine that's been governing directed trusts and that presumably will continue to govern them in non-UDTA jurisdictions. In addition, I'll address how equity doctrine applicable to directed trusts would be altered in UDTA jurisdictions.¹

Pre-UDTA Equity Doctrine

In the 1960s, primarily in the employee benefit space, a non-beneficiary third party who was granted a power to control a trustee in the performance of its investment responsibilities was known as a trust "advisor," an obvious misnomer in that far more was going on than the mere rendering of investment advice.² "By the 1990s, trust advisers had morphed into trust protectors, who were conceived of as a means of securing the settlor's control over an off-shore asset protection trust. More recently, trust protectors have become popular for all trusts, not just the off-shore variety."³ The powers of a trust protector supersede those of the trustee.⁴ Noted trusts and estates attorney Alexander A. Bove, Jr., of Bove and Langa in Boston, defines the trust protector as a "party who has overriding discretionary powers with respect to the trust but who is not a trustee."⁵ That is, a trust director is a trust advisor whose powers can extend beyond asset management to include some form of non-judicial oversight of the trustee's other activities.

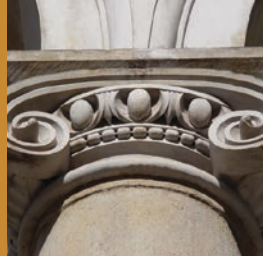
Scope of the trust protector's duties. Because the scope of a trust protector's duties may fall somewhere between the nonexistent (think holder of a special non-fiduciary power of appointment (POA)) and the broad (think full-fledged trustee),⁶ one contemplating serving as a trustee or a trust protector of a trust that provides for both offices needs to be wary.⁷ What are: (1) the trustee's duties, if any, to monitor the activities of the trust protector; (2) the duties and liabilities of the trustee protector, for example, whether he's a fiduciary; (3) the rights of the trust protector, for example, whether he's entitled to be compensated for his services and indemnified for his liabilities; and (4) the tax consequences for all concerned of the trust protector possessing and/or exercising his authority?⁸

When the protector is the de facto trustee. Equity looks to the intent (substance) of an arrangement, not to its form. Thus, "[w]here the trustee is not able to take any—or practically any—step in the ... [trust] ... administration without securing protector approval, the balance of power is so radically altered that it may be concluded that the trustee is no more than a custodian and the protector is, in reality, the trustee."⁹

Protectors are generally fiduciaries. *Restatement (Third) of Trusts (Restatement Third)* says that: "[a]bsent some clear indication of a settlor's contrary intent, powers granted to a protector ... probably should be deemed to be held in a fiduciary capacity ... , even if not strictly that of a trustee."¹⁰ Bove is generally in accord.¹¹ So is the UDTA. The scholarly writings of Kathleen R. Sherby, partner at Bryan Cave in St. Louis, suggest that she's generally not in accord.¹² In any case, in a jurisdiction that endorses the *Restatement Third's* presumption of fiduciary status, indicating a contrary intent may be easier said than done. Take the following provision: "For the avoidance of doubt, it is hereby declared that no power is



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vested in the protector in a fiduciary capacity.” In a case involving a trust with just such language, the court held that because elsewhere, the instrument provided that the protector shall exercise his powers for the benefit of the beneficiaries, specifically the powers to appoint successor trustees and protectors, he was bound by fiduciary constraints in their exercise.¹³ The only purpose of the exoneration language was to relieve the protector of any fiduciary duty to consider from time to time whether or not to exercise.¹⁴

If a protector’s authority is neither personal nor fiduciary, then what, if any, are its limitations?:

At a minimum, an adviser or protector with powers over a trust that are neither fiduciary nor personal would not be allowed to exercise them fraudulently and presumably would at least be held to a good faith standard...Further, if, as typically would be the case if the power were not personal, the power had been granted to the adviser or protector to further the settlor’s purposes in benefitting the trust’s beneficiaries, it presumably could not be exercised for the powerholder’s own benefit.¹⁵

The power of a protector to appoint a successor trustee is almost certainly a fiduciary power, absent special facts. The UDTA, as we shall see, would seem not to be in accord.¹⁶ One Jersey court (the Crown dependency) offers a list of the duties a protector assumes in electing to exercise such a power:

- To act in good faith and in the interests of the beneficiaries as a whole;
- To reach a decision open to a reasonable appointor;
- To take into account relevant matters and only those matters; and
- Not to act for an ulterior purpose.¹⁷

While the fiduciary protector takes on more general liability exposure than the non-fiduciary protector, the opposite may well be the case in one context, namely, when it comes to personal liability for trust-related expenses, such as attorney’s fees. One court has ordered that a fiduciary protector, whose discretionary actions were challenged by a trust beneficiary, be indemnified from the trust estate for his personal litigation defense

costs, the court suggesting that had the protector not been a fiduciary, he, qua protector, wouldn’t have had recourse to the trust estate.¹⁸ As the UDTA generally deems a trust director to be a fiduciary, the commentary accompanying its Section 14 should come as no surprise:

Attorney’s fees and indemnification for a trust director are governed by Section 6(c)(1), which establishes a default rule that allows a trust director to exercise ‘any further power appropriate to the exercise or nonexercise of the director’s power of direction.’ By default, therefore, a trust director

The UDTA declines to regulate the powers of a trust director to appoint or remove a trustee or trust director.

has a power to incur attorney’s fees and other expenses and to direct indemnification for them if ‘appropriate’ to the exercise of the director’s express powers.

The UDTA

The UDTA would govern irrevocable directed trusts. For its purposes, a directed trust is a trust whose terms grant a power of direction to someone other than the trustee, such as a power over the investment, management or distribution of trust property. That someone is a “trust director.” A non-fiduciary POA isn’t such a power.¹⁹ Background general principles of equity, however, would continue to govern whether a holder of a particular power of direction isn’t a trust director but either a true co-trustee or the donee of a non-fiduciary POA.²⁰ The UDTA makes no effort to regulate the critical threshold exercise of sorting out whether someone who’s been designated a trust director in the terms of a particular trust actually is one, or whether, for that matter, an express negation of trust director status in the terms of a particular trust is effective.²¹

The public policy that the UDTA would implement



is that a trust director should be a fiduciary with an affirmative duty to act.²² A breach of the trust director's fiduciary duty should be a breach of trust.²³ A beneficiary's primary recourse for misconduct by a trust director should be an action against the director for breach of the director's fiduciary duty to the beneficiary.²⁴ The directed trustee incurs secondary liability only to the extent of his own willful misconduct.²⁵

It's black letter law that neither the holder of a non-fiduciary POA nor an agent fiduciary has an affirmative duty to act.²⁶ A trustee, on the other hand, does. Now, so would a trust director. Subject to the limitations of his powers of direction and to legal title to the subject

The UTC and the UDTA treat veto powers differently when it comes to directed trustee liability.

property being in someone else, under the UDTA, the trust director essentially possesses all the rights, duties, obligations and liabilities of a true trustee.²⁷

It's been classic equity doctrine that a directed trustee, no matter how expansive the exculpatory language, at least owes the trust beneficiary a duty not to knowingly participate in a breach of trust, particularly as even a non-party to the trust relationship would owe the beneficiary such a duty.²⁸ The Uniform Trust Code (UTC) seems in accord.²⁹ In the directed trust context, however, the knowing participation standard apparently would be replaced by a willful misconduct standard. UDTA Section 9(b) provides that a directed trustee may not comply with the exercise of a power of direction to the extent that by complying, the trustee would engage in willful misconduct. Are "knowing participation in a breach of trust" and "willful misconduct" synonymous proscriptive standards in the directed trust context? Or, is the willful misconduct standard more encompassing? Or, is it less? Though Section 9(b) is by no means the only place in the UDTA where the term "willful misconduct" is employed, nowhere in the UDTA is it defined.³⁰

The UDTA declines to regulate the powers of a trust

director to appoint or remove a trustee or trust director.³¹ Presumably, general principles of equity would regulate the exercise of such a power, such as the duty of even a non-fiduciary, non-party to a trust relationship to refrain from knowingly participating in its breach. An appointment or removal incident to a conspiracy to embezzle comes to mind.

Trustees subject to third-party veto would definitely have oversight responsibilities under the UTC: "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 appropriate action if the third party's refusal to consent would result in a serious breach of trust."³² The UDTA isn't in accord. It provides that "a trustee that operates under this kind of veto or approval power has the normal duties of a trustee regarding the trustee's exercise of its own powers, but has only the duties of a directed trustee regarding the trust director's exercise of its power to veto or approve."³³

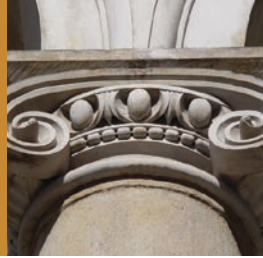
UDTA Traps for the Unwary


As is the case with any piece of legislation that would tweak equity doctrine, the UDTA has its traps for the unwary. Here are a few:

- Under the UDTA, the directed trustee is liable only for his own "willful misconduct," while under the UTC, specifically Section 808(b), the trustee may not honor a direction that's "manifestly contrary to the terms of the trust or the [directed] 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."
- While the UDTA is almost all about non-trustee directors, buried in the UTC, specifically Section 12, is some co-trustee to co-trustee direction doctrine.
- The UDTA doesn't apply to powers to hire and fire trustees and trust directors.³⁴ Presumably background principles of equity will continue to regulate those types or directions.
- The UTC and the UDTA treat veto powers differently when it comes to directed trustee liability.³⁵

What's Intended

While at the technical level, parts of the UDTA aren't models of clarity, and its synchronization with other trust-related codifications could be better, at the policy



level there can be no doubt as to what's intended. In a jurisdiction that enacts the UDTA, a trust director shall be a fiduciary with an affirmative duty to act; a breach of a trust director's fiduciary duty to the beneficiaries shall be a breach of trust; a trust beneficiary's primary recourse for a trust director's breach of trust shall be an action directly against the director; and a directed trustee shall incur secondary liability only to the extent of his own willful misconduct. 

Endnotes

1. For purposes of the Uniform Directed Trust Act (UDTA) and this article, a "trust protector" and a "trust director" are synonymous. The UDTA employs the term "trust director."
2. See generally Note, "Trust Advisers," 78 Harv. L. Rev. 1230 (1965).
3. Lawrence A. Frolik, "Trust Protectors: Why They Have Become 'The Next Big Thing,'" 50 Real Prop, Tr. & Est. L. J. 267, 270 (2015).
4. *Ibid.*
5. See Alexander A. Bove, Jr., "The Trust Protector: Friend, Foe, or Fiduciary?"

- 34th Annual Notre Dame Tax and Estate Planning Institute, South Bend, Ind. (Sept. 25-26, 2008).
6. Trust protectors have been given authority to do one or more of the following: remove and appoint trustees; review trust administration and approve accounts; appoint auditors; agree to trustee compensation; approve self-dealing by trustees; petition the court on behalf of unborn or unascertained remaindermen; export the trust and change the governing law; trigger or cancel flight arrangements in flee clauses; withhold consent to investment, distributive and administrative decisions of the trustees; direct trustees to exercise of investment, distributive and/or administrative discretions; provide and obtain tax advice for the trustees; veto a settlor's exercise of reserved powers; decide whether the settlor is incapacitated so as to trigger suspension of reserved powers; and add members to or subtract members from a class of permissible discretionary beneficiaries. Jeffrey A. Schoenblum, *Multistate and Multinational Estate Planning* 1372-1374 (1999). Professor Schoenblum acknowledges Prof. David Hayton for developing a comprehensive list of trust protector functions. David Hayton, "English Fiduciary Standards and Trust Law," 32 Vand. J. Transnat'l L. 555, 583-584 (1999). That list is reproduced in par. 18.18[C][9] of Prof. Schoenblum's treatise. A slightly modified version of the list appears in this endnote. See generally 3



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FEATURE: FIDUCIARY PROFESSIONS

- Scott & Ascher par. 16.7 (Effect of Power to Direct or Control Trustee).
7. See generally James L. Dam, “More Estate Planners Are Using ‘Trust Protectors,’” 2001 *LWUSA* 854 (Oct. 29, 2001) (citing a Pennsylvania estate-planning attorney to the effect that in the United States, settlors who designate trust protectors are venturing into “uncharted territory”).
 8. See *ibid.* (suggesting that there’s little “default law” addressing the powers and duties of protectors). See generally Scott & Ascher, *supra* note 6.
 9. Dawn Goodman and Sarah Aughwane, “Who Holds the Gun?” 21 *STEP J.* 51 (October 2013).
 10. *Restatement (Third) of Trusts*, Reporter’s Notes on Section 64. See also 5 Scott & Ascher, *supra* note 6, at Section 331.3 (Termination or Modification by Third Person).
 11. See Alexander A. Bove, Jr., *The Development, Use, and Misuse of the Trust Protector and its Role in Trust Law and Practice 2*, Schulthess (2014); *supra* note 5; Alexander A. Bove, Jr., “The Case Against the Trust Protector,” 37 *ACTEC L.J.* 77 (Summer 2011) (making the case that a trust protector can’t be the agent of either the settlor or the trustee).
 12. See, e.g., Kathleen R. Sherby, “In Protectors We Trust: The Nature and Effective Use of Trust Protectors,” 49th Annual Heckerling Institute on Estate Planning (Jan. 12-16, 2015). In his article, Bove endeavors to make the case that Sherby’s advocacy for a default presumption that a protector isn’t a fiduciary is doctrinally incoherent. See Alexander A. Bove, Jr., “A Protector by any Other Name,” 8 *Est. Plan. & Cmty. Prop. L.J.* 389 (2016).
 13. *Centre Trs. v. Van Rooyen*, WTJR 17 (R.C. Jersey 2010).
 14. *Ibid.*
 15. Alan Newman, “Trust Law in the Twenty-First Century: Challenges to Fiduciary Accountability,” 29 *Quinnipiac Prob. L. J.* 261, 300-301 (2016).
 16. See UDTA Section 5(b)(2), cmt.
 17. See *Representation of Jasmine Trustees Ltd.*, JRC 196 (R.C. Jersey 2015).
 18. See *In the Matter of the Piedmont Trust and the Riviera Trust*, JRC 016 (R.C. Jersey 2016).
 19. See UDTA Section 5(b)(1). Non-fiduciary powers of appointment are taken up generally in Section 8.1.1 of *Loring and Rounds: A Trustee’s Handbook* (2018) (*Lorings and Rounds*).
 20. See UDTA Section 4, cmt. (“This section confirms that the common law and principles of equity remain applicable to a directed trust except to the extent modified by this act or other law.”)
 21. See UDTA Section 2(9), cmt.
 22. In a given situation, a trust director may not necessarily be authorized to act immediately on acceptance of the directorship, such as in the case of a springing directorship. See UDTA Section 8, cmt.
 23. UDTA Section 2(1).
 24. UDTA, Prefatory Note.
 25. *Ibid.*
 26. See generally *Loring and Rounds supra* note 19, Section 8.1.1 (the holder of a non-fiduciary power of appointment generally isn’t duty-bound to exercise the power) and Section 6.1.2 (under classic black letter law, an agent qua agent isn’t duty-bound to act; he’s merely authorized to act).
 27. See, e.g., UDTA Section 8(a) (providing that if a power of direction is held individually rather than jointly, the trust director has the same fiduciary duty and liability in the exercise or non-exercise of the power as would a sole trustee in a like position and under similar circumstances). See also Section 16 (providing that the default rules applicable to a trusteeship apply as well to a trust directorship when it comes to acceptance of the fiduciary office, giving of fiduciary bond, fiduciary compensation, fiduciary resignation, fiduciary removal and the filling of fiduciary vacancies).
 28. See generally Section 7.2.9 of *Loring and Rounds, supra* note 19 (personal liability of non-parties to the trust relationship).
 29. Uniform Trust Code Section (UTC) 808(b) (providing that a trustee shall honor the direction of a trust director “unless the attempted exercise is manifestly contrary to the terms of the trust or the trustee knows the attempted exercise would constitute a breach of fiduciary duty that the ... [trust director] ... owes to the beneficiaries of the trust”).
 30. That having been said, there’s UDTA commentary to the effect that “willful misconduct” and “intentional misconduct” are synonymous. See UDTA Section 9, cmt.
 31. See UDTA Section 5(b)(2).
 32. UTC Section 808, cmt.
 33. UDTA Section 9, cmt.
 34. See UDTA Section 5(b)(2).
 35. See UTC Section 808, cmt and UDTA Section 9, cmt.



SPOT LIGHT

Cat Nap

L'Été Chat sur une Balustrade by Théophile Steinlen sold for \$4,500 at Swann Auction Galleries' Old Master Through Modern Prints sale in New York City on Nov. 2, 2017. A big lover of cats, Steinlen often featured the feline figure in his works. For many years, Steinlen produced illustrations under a pseudonym to avoid political problems because of the harsh criticisms of society in his works.