

**DIRECTED TRUSTS: SLICING AND DICING TRUSTEE'S
DUTIES AND RESPONSIBILITIES**

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DIRECTED TRUSTS

- A. Introduction. Directed trusts are not new. Delaware statutorily recognized the power of the trustor of a trust to restrict a trustee's authority to dispose of or otherwise deal with specified trust assets for more than thirty years. 12 Del. C. § 3313 (65 Laws 1986, ch. 422, § 5). Prior to the statute, going back to the early 1900s, Delaware adopted the practice of allowing directed trusts to accommodate its wealthiest families.

In their earliest form, directed trusts tended toward the limitation of a trustee's power to sell specific trust assets without the consent or written direction of a person not serving as trustee. Today the limitations on a trustee's authority often extends to all of the trustee's discretionary powers over trust assets including voting decisions, management decisions, distribution decisions and other decisions previously solely within the realm of the trustee's discretion.

The desire of wealthy families to preserve their control over the stock of the corporation founded by their ancestors and the recognition that today's trusts often hold new kinds of unique trust investments have driven the issue of directed trusts. In fact, trustees faced with the fiduciary duty to diversify trust assets and deal impartially with income beneficiaries and remainder beneficiaries welcome the ability to limit their liability through the use of directed trusts.

The result has been the creation of a statutory framework authorizing a trustor (or the trustee and the trust beneficiaries through appropriate trust modification proceedings) to include in trust instruments a new regime for the administration of specific trust assets. In addition to the traditional trustee, the new regime often includes trust advisers or Co-Trustees with exclusive authority over specific trust powers. See, Rachel Emma Silverman, *How Many Trustees Do You Need?* Wall St. J., July 12, 2007, at B5. It is the recognition of Trustor autonomy and freedom of disposition that led to the Uniform Directed Trust Act ("UDTA"). See, Preface to the UDTA p. 1.

- B. Definition. A directed trust is a trust that removes one or more powers or discretions traditionally held by the trustee and vests that power or discretion in a person who is either a special trustee or not a trustee at all. The power or discretion can relate to investment decisions, management decisions, distribution decisions and any other decision affecting the administration of the trust. The starting point for the creation of directed trusts is the statutory framework that permits them coupled with the carefully worded language of the trust instrument.
- C. Statutory Recognition of "Advisers". A trustor's statutory power to dictate the rights and obligations of the beneficiaries and trustee through the express terms of a trust instrument and the trustee's statutory right to rely in good faith on the terms of the trust instrument for protection from liability are essential to the effective use of directed trusts. Five different approaches are illustrated below.

1. UTC. Section 808(b) of the Uniform Trust Code states:

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

2. Third Restatement. Section 75 of the Third Restatement of Trusts states:

...[I]f the terms of a trust reserve to the settlor or confer upon another a power to direct or otherwise control certain conduct of the trustee, the trustee has a duty to act in accordance with the requirements of the trust provision reserving or conferring the power and to comply with any exercise of that power, **unless the attempted exercise is contrary to the terms of the trust or power or the trustee knows or has reason to believe that the attempted exercise violates a fiduciary duty that the power holder owes to the beneficiaries.** [emphasis added]

3. UDTA. The UDTA adopts the same standard of liability for a directed trustee as Delaware. Section 9(b) of the UDTA states:

A directed trustee must not comply with a trust director's exercise or non-exercise of a power of direction or further power under Section 6(b)(1) to the extent that **by complying the trustee would engage in willful misconduct.** [emphasis added]

4. No Liability Jurisdictions. Alaska, New Hampshire, Nevada and South Dakota rejected the "willful misconduct" mandatory minimum fiduciary standard under the UDTA and Delaware law. They chose instead to completely exculpate a directed trustee from liability for following a Trust Director's direction. See, Comment to Section 9 of the UDTA.

5. Delaware Provisions. The foregoing provisions for directed trusts should be compared with the more detailed provisions adopted by Delaware and a few other states.

- (a) Delaware law recognizes a broad class of advisers including direction advisers, consent advisers and trust protectors. Where one 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 decisions of the fiduciary, such persons shall be considered to be advisers and fiduciaries when exercising such authority unless the governing instrument otherwise provides. 12 Del. C. § 3313(a).
- (b) When a trustee acts in accordance with the directions of a trust direction adviser, the trustee will only be liable for its "willful misconduct".

Direction Provision

If a governing instrument provides that a fiduciary is to follow the direction of an adviser or is not to take specified actions except at the direction of an adviser, and the fiduciary acts in accordance with such a direction, then **except in cases of willful 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. 12 Del. C. § 3313(b). [emphasis added] The term willful misconduct means intentional wrongdoing and not mere negligence, gross negligence or recklessness. 12 Del. C. § 3301(g) and 12 Del. C. § 3301(h)(4). The term wrongdoing means malicious conduct or conduct designed to defraud or seek an unconscionable advantage. 12 Del. C. § 3301(g).

- (c) The statutory standard of care required of a fiduciary acting on the consent of a Consent Adviser is only somewhat broader. When a trustee acts with the consent of a Consent Adviser, the trustee will only be liable for its "willful misconduct" or "gross negligence".

Consent Provision

If a governing instrument provides that a fiduciary is to make decisions with the consent of an adviser, then **except in cases of willful 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 act or failure to provide such consent after having been requested to do so by the fiduciary. 12 Del. C. § 3313(c). [emphasis added]

- (d) In all cases, there may be an adviser who is a “trust protector”.

Trust Protector

... the term “adviser” shall include a “protector” who shall have all of the power and authority granted to the protector by the terms of the governing instrument, which may include but shall not be limited to:

- i. The power to remove and appoint trustees, advisers, trust committee members, and other protectors;
 - ii. The power to modify or amend the governing instrument to achieve favorable tax status or to facilitate the efficient administration of the trust; and
 - iii. The power to modify, expand, or restrict the terms of a power of appointment granted to a beneficiary by the governing instrument. 12 Del. C. § 3313(f).
- (e) The statutory protection afforded trustees of directed trusts would be diminished if advisers or beneficiaries could sue the trustee on the theory that the trustee had a duty to keep them informed and to impart to them knowledge affecting their interests in the trust so they could perform their duties as advisers or otherwise protect their beneficial interests in the Trust.

Duty to Monitor, Communicate and Inform

Whenever a governing instrument provides that a fiduciary is to follow the direction of an adviser with respect to investment decisions, distribution decisions, or other decisions of the fiduciary or shall not take specified actions except at the direction of an adviser, then, except to the extent that the governing instrument provides otherwise, **the fiduciary shall have no duty to:**

- i. **monitor the conduct of the adviser;**
- ii. **provide advice to the adviser or consult with the adviser; or**
- iii. **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.** 12 Del. C. § 3313(e). [emphasis added]

* * *

Absent clear and convincing evidence to the contrary, the actions of the fiduciary pertaining to matters within the scope of the adviser's authority (such as confirming that the adviser's directions have been carried out and recording and reporting actions taken at the adviser's direction), shall be presumed to be administrative actions taken by the fiduciary solely to allow the fiduciary to perform those duties assigned to the fiduciary under the governing instrument and such administrative actions shall not be deemed to constitute an undertaking by the fiduciary to monitor the adviser or otherwise participate in actions within the scope of the adviser's authority. Id.

- (f) The UDTA followed this model. Unless the terms of a trust provide otherwise, **neither the trustee nor the trust director has a duty to monitor the other or inform or give advice to an interested party that one may have acted differently than the other under the circumstances.** UDTA Section 11. [emphasis added]
- (g) Recognizing the multiple roles played by different fiduciaries, Delaware adopted 12 Del. C. § 3317 in 2010. The statute states that, except as provided in the governing instrument, each trust fiduciary (including trustees, advisers, protectors, and other fiduciaries) has a duty to keep the other fiduciaries reasonably informed about the administration of the trust with respect to the specific duty or function being performed by that fiduciary. The statute further provides that a fiduciary who requests and receives such information has no duty to monitor the conduct of the other

fiduciary, provide advice or consult with the other fiduciary or communicate or warn any beneficiary or third party concerning instances in which the fiduciary receiving the information would or might have exercised the fiduciary's own discretion in a different manner. 12 Del. C. § 3317.

- (h) The UDTA follows this model by requiring the trustee and the trust director to provide information to each other reasonably related to their respective powers and duties. UDTA Section 10.
- (i) One aspect of the directed trust structure that is often overlooked is the potential liability of the adviser appointed to direct the trustee with respect to investment decisions, distribution decisions or other decisions of the trustee. Absent express language in the governing instrument such adviser is deemed to serve in a fiduciary capacity and will be held to the prudent person standard. However, Delaware law permits a trust agreement to exculpate and indemnify a fiduciary (including an adviser) for all acts other than those committed with willful misconduct. 12 Del. C. § 3303(a).
- (j) There are two provisions of the UDTA that were not part of Delaware statutory law before the UDTA was adopted. Both were considered extremely beneficial and both were adopted and became Delaware law in 2018. The first was jurisdictional. Section 15 of the UDTA states that by accepting appointment as a trust director, the director submits to the personal jurisdiction of the court in the state where the trust is administered for any matter relating to the power or duty of the director. This provision was adopted as 12 Del. C. § 3313(g) which states that a person who accepts appointment as an adviser or acts as an adviser of a trust submits to personal jurisdiction in Delaware for any matter related to the trust. The second provision was more functional. Section 12 of the UDTA recognizes that directed trusts may be administered through a co-trustee (rather than trust director) design and relieves a co-trustee from liability for a co-trustee's exercise or non-exercise of a power to the same extent as if the relieved co-trustee were a directed trustee. This became the Delaware excluded co-trustee statute. 12 Del. C. §3313A.

D. Directed Trusts – The Language of the Trust Instrument. Once the statutory framework is in place, the focus shifts to the specific language of the trust instrument.

1. Trust Adviser Language. The particular adviser language included in the trust instrument depends upon the purpose for which the trust is created and the reason why the adviser is appointed. There are innumerable reasons why trustors create directed trusts and it would be impossible to include in this outline all of the language used over the years creating directed trusts. Most directed trusts do, however, fall into certain categories and the most common are illustrated below.

(a) Investment Direction Adviser. The most common form of directed trust is one that is directed with respect to investment decisions. Often trustors find it desirable to bifurcate traditional trustee responsibility through the appointment of an Investment Direction Adviser that has the ability to direct the trustee with respect to the investment of the trust assets.

The most common reasons for the use of an Investment Direction Adviser are: (1) the trust will be funded with a concentrated position that a corporate trustee would be uncomfortable holding or (2) the trustor would like to appoint a trustee to administer the trust and be responsible for distribution decisions while allowing the trustor's financial advisor to make all investment decisions for the trust. By designating a trustee in a jurisdiction that allows directed trusts the trustor is able to bifurcate these traditional trustee responsibilities and vest all investment authority in the third party adviser.

(b) Special Holdings Direction Adviser. Another common use of the directed trust structure is the bifurcation of investment responsibilities only with respect to a certain class of assets. For example, the trust may be funded with a combination of marketable securities as well as an ownership interest in the trustor's family business. The trustor would like the corporate trustee to manage and invest the marketable assets however neither the trustor nor the corporate trustee want the corporate trustee to participate in any decisions relating to the trustor's family business. It is possible to appoint an adviser (i.e. Special Holdings Direction Adviser) that has the ability to direct the trustee as to the

special assets while at the same time allowing the trustee to be responsible for the investment and management of the marketable securities held in the trust.

Another reason to include the position of Special Holdings Direction Adviser applies when the trustor wants to retain investment control over the trust by serving as the Investment Direction Adviser of the trust. It is possible that a trust may be funded with certain assets (i.e., life insurance policies insuring the trustor's life or voting stock of a controlled corporation under IRC Section 2036(b)) where the trustor's retention of investment control over the trust assets could result in the trust assets being includible in the trustor's estate for Federal Estate Tax purposes. In this situation it is desirable to carve out the problematic assets and define them as "Special Holdings." The trustor can retain the ability to direct investments with respect to the non-Special Holdings and a third party adviser can be appointed to direct the trustee as to the investment of the Special Holdings.

- (c) Distribution Adviser. Another common use of the directed trust structure is to bifurcate distribution responsibility through the appointment of a Distribution Adviser who has the ability to direct the trustee when and how the beneficiaries will receive distributions from the trust based on the standards contained in the trust instrument. Often a trustor will want a corporate trustee to be responsible for the investment and administration of trust assets but will want someone who is more familiar with the beneficiaries and their particular needs to decide when distribution should be made to the beneficiaries. This may be particularly true where the beneficiaries have special needs or substance abuse issues. It is also a desirable tool in situations where the trustor has specific ideas about how and when distributions will be made to the beneficiaries. The trustor could appoint a family member or trusted adviser, who will have much more intimate knowledge of the family and their circumstances than the corporate trustee, to direct the trustee regarding trust distributions.
- (d) Trust Protector. One of the more powerful positions that can be created in the directed trust structure is that of Trust Protector. Often the Trust Protector is vested with key powers that will allow

the trust instrument to remain flexible as circumstances change over time. Typical Trust Protector powers include the following:

- i. The ability to amend the trust for administrative and tax purposes;
- ii. The power to change the situs and governing law of the trust;
- iii. The power to appoint, remove and replace the trustee and other trust advisers;
- iv. The ability to convert the trust from a grantor trust into a non-grantor trust for income tax purposes; and
- v. The power to expand the permissible class of beneficiaries of the trust.

One issue that often arises is whether the Trust Protector should serve in a fiduciary or non-fiduciary capacity. Under Delaware law, a Trust Protector is deemed to serve in a fiduciary capacity unless the terms of the governing instrument provide otherwise. 12 Del. C. § 3313(a). It is common practice to have the Trust Protector serve in a fiduciary capacity. However, there are certain powers that may be conferred upon the Trust Protector which could only be exercised in a non-fiduciary capacity (i.e. the ability to convert the trust from a grantor trust to a nongrantor trust for income tax purposes, the power to expand the permissible class of beneficiaries of the trust or to substitute assets of equivalent value or to avoid state income tax in states that tax trust income based on whether a trust fiduciary resides in the state).

The UDTA recognizes the need to permit a trust director to serve in a non-fiduciary capacity but only for federal (not state) tax purposes. Section 5(a)(5) of the UDTA permits the terms of a Trust to provide that a power may be held in a non-fiduciary capacity but only when the “power must be held in a non-fiduciary capacity to achieve the settlor’s tax objective under the United States Internal Revenue Code of 1986”.

- E. Definition. Purely administrative trustees provide only trust administration services. Example: A wealthy New York resident wishes to create a perpetual trust in Delaware for tax purposes with marketable securities. The trustor already has a sophisticated team of financial planners and investment advisers. The trustor creates a Delaware limited liability company (“LLC”) to which he transfers marketable securities. The trustor then creates a Delaware dynasty trust

naming a Delaware trustee as a Purely Administrative Trustee. The only asset held by the Delaware trustee is the LLC units. The language of the trust instrument includes a Special Holdings Direction Adviser to direct the trustee with respect to all matters concerning the LLC units held in trust. Because the trust may one day hold investment assets, the trust is a directed trust with an Investment Direction Adviser named to direct the trustee with respect to all matters concerning trust investments. There is a Distribution Adviser to direct the trustee with regard to trust distributions. A Trust Protector provision is included allowing the Trust Protector to remove and replace the trustee, the Special Holdings Direction Adviser, the Investment Direction Adviser and the Distribution Adviser. The Trust Protector may also change the situs of the trust as well as the law governing its administration and modify the language of the trust instrument to obtain favorable tax treatment or facilitate the efficient administration of the trust.

1. Administrative Trustee Duties. The only duties performed by the Administrative Trustee are to hold the LLC units, maintain trust records, prepare or otherwise arrange for the preparation of fiduciary income tax returns, keep account records, facilitate communications with trust beneficiaries, and maintain an office for its business in the state. The trustee has no liability for actions taken or not taken by the Special Holdings Direction Adviser, the Investment Direction Adviser, the Distribution Adviser and the Trust Protector absent the trustee's willful misconduct.

F. Trustee Fees. Administrative trustees, recognizing the limited role they play, offer low fees for trust services. Typically, administrative trustees will serve for annual fees of anywhere from \$3,500 to \$10,000 per trust. To illustrate the fee structure, below are actual fee quotes from two Delaware trust companies for providing trust services in different capacities for a trust with assets valued at \$7.5 million.

Bank I

1. Where we hold only an LLC interest, our fee is \$5,000 per year.
2. Where we hold liquid assets, subject to direction on investments, our fee is \$24,000 per year.
3. Where we hold liquid assets, but have full discretion as to investments, our fee is \$77,000 per year.

Bank II

1. Bank II is hired as trustee. Under this scenario, there is no direction adviser. Bank II is trustee and manages the investment portfolio at its discretion, subject to the terms of the trust document. The fee schedule is as follows:

<u>Fee Schedule</u>	<u>Rate</u>	<u>Balance</u>	<u>Fee</u>
First \$2,000,000 of principal value	0.500%	\$2,000,000	\$10,000
Next \$3,000,000	0.375%	3,000,000	11,250
Next \$5,000,000 of principal value	0.350%	<u>2,500,000</u>	<u>6,250</u>
	Total	\$7,500,000	\$27,500

2. Bank II is hired as trustee. The trust holds LLC units only and Bank II, the administrative trustee, is directed to hold the LLC units in the trust.

\$6,000 for the first \$10 MM of assets held in the LLC

\$10,000 for assets valued between \$10 MM and \$20 MM in the LLC.

- G. Fully Directed Trusts. Purely administrative trustees evolved from the carefully crafted language of trust instruments that define the duties and responsibilities of various advisers to the trust. The combination of Direction Advisers and Distributions Advisers coupled with the power of the Trust Protector resulted in the development of a trust concept where the formerly fully responsible corporate trustee now serves only in an administrative capacity while all of the duties and responsibilities traditionally vested in the corporate trustee rest now in the hands of advisers and protectors to the trust.
- H. Liability Issues. Can directed trusts protect fiduciaries from liability? Will the statutory framework previously discussed and the language of the trust instrument really work? Two state court decisions on the matter may be helpful in answering these questions. One is a Delaware decision and the other is a Virginia decision. Both involve Investment Direction Advisers.

1. The Delaware Decision. In *Duemler v Wilmington Trust Co.*, C.A. No. 20033 N.C. (Del. Ch. 2004), the corporate trustee was sued by an individual co-trustee who was the sole Investment Direction Adviser of a trust established by his family. The Investment Direction Adviser chose not to tender securities owned by the trust when he had the option to do so. The issuer defaulted and the Investment Direction Adviser sued the corporate trustee alleging the corporate trustee breached its fiduciary duty to the trust by, among other things, failing to provide the Investment Direction Adviser with appropriate financial information to allow the Investment Direction Adviser to make an informed decision. The case was litigated in the Delaware Court of Chancery.

(a) The Ruling. The Court's decision is not reported but the Court's order is. The Court was so certain of the proper outcome of the case that it ruled from the bench. A copy of the transcript of the decision may be obtained by email request to pgordon@gfmlaw.com. Relevant quotes are set forth below.

THE COURT: I'm in a position to rule. I'm not going to require that the parties expend additional resources on this. The matter is abundantly clear to me. (Tr. P. 3, L. 2-5).

* * *

...Mr. Duemler was the investment adviser for a high-risk approach to investing of particular - of assets under a particular trust. Had he wished for Wilmington Trust to be investment advisor to run a high-risk portfolio - I'm sure Wilmington Trust likes to make money. It would be willing to do it. It costs a lot more. (Tr. P. 3, L. 10-16).

Finding that the trust held "a nondiversified portfolio with extremely risky assets" (Tr. P. 11, L. 22-23), the court stated: I think in terms of the division of trust responsibilities, it was absolutely clear that this was on Mr. Duemler's side of the ledger. (Tr. P. 12, 9-11).

The Court held that the proximate cause of the loss was "the breach of fiduciary duty by Mr. Duemler" who had the primary responsibility for being the investment adviser. (Tr. P. 13, L. 4-13).

Paragraph 4 of the Final Order And Judgement states:

“The Court further finds that section 3313(b) of title 12 of the Delaware Code insulates fiduciaries of a Delaware trust from liability associated with any loss to the trust where a governing instrument provides that the fiduciary is to follow the direction of an advisor, the fiduciary acts in accordance with such direction and the fiduciary did not engage in willful misconduct. The trust agreement involved in this case appointed Plaintiff as the investment advisor to the Trust and, at all times, Plaintiff made all of the investment decisions for the Trust, including not to tender the securities in the Exchange Offer. In connection with Plaintiff’s decision not to tender the securities in the Exchange Offer, Wilmington Trust acted in accordance with Plaintiff’s instructions, did not engage in willful misconduct by not forwarding the Exchange Offer materials to Plaintiff and had no duty to provide information or ascertain whether Plaintiff was fully informed of all relevant information concerning the Exchange Offer. Accordingly, 12 Del. C. § 3313(b) insulates Wilmington trust from all liability for any loss to the Trust resulting from Plaintiff’s decision not to tender the securities in the Exchange Offer”. *Duemler v. Wilmington Trust Company*, 2004 WL5383927 (Del. Ch. Nov. 24, 2004).

- (b) Significance of the Decision. The Court upheld the statutory defense under 12 Del. C. § 3313(b) (Delaware’s directed trust statute) and noted that the case was “an apt instance for its application” because there was “absolutely no evidence of willful misconduct” on the part of Wilmington Trust Company. (Tr. P. 15, L. 12-16). Moreover, the court admonished the investment direction adviser for arguing that the trustee was responsible for failure to provide relevant information. The court stated: And you don’t get to come in and hang your fellow fiduciary on that unless they engaged in willful misconduct. There is none there. “And if I were to rule that, ‘oh, no. What the problem is here is the failure to provide information or to make sure that the fiduciary making the decision knew what they were doing,’ I think that would gut the statute”. (Tr. P. 16, L. 5-12).

The court's clear recognition of the intent and purpose of the directed trust statute and its firm ruling upholding the statute is a clear indication that Delaware courts will enforce directed adviser provisions in a trust instrument based on the statutory framework that permits them.

2. The Virginia Decision. In *Rollins v Branch Banking and Trust Company of Virginia*, 2001 W.L. 34037931 (Va. Cir. Ct.), the plaintiffs were children and grandchildren of the grantors of two trusts created in 1977 for their benefit. The plaintiffs were suing the corporate trustee for breach of fiduciary duty, in particular, the trustee's failure to diversify trust investments. The trusts were funded primarily with shares of stock in two textile corporations. At the inception of the trusts, the trustee "obtained the written authority of the beneficiaries to over-concentrate the trust" with textile stocks. *Rollins*, at *1. The trust remained over concentrated in the textile stock until 1997 (20 years later) when the stock was sold. The beneficiaries sued the trustee for \$25 million, the amount they claim they lost due to the trustee's failure to diversify the trust investments. The trustee, citing the Virginia directed trust statute, filed the equivalent of a motion for summary judgment contending that when, as here, the trust vests the power to make investments decision exclusively in persons other than the trustee, the trustee cannot be liable for the loss resulting from the retention of the investment. *Rollins*, at *2.

- (a) The Ruling. The court ruled in favor of the corporate trustee citing the Virginia directed trust statute and quoting the specific language of the trust instrument. The Virginia trust statute (which has since been changed to a version closer to the UTC provision) then provided:

§ 26-5.2. Liability of a fiduciary for actions of cofiduciary. Whenever the instrument under which a fiduciary or fiduciaries are acting reserves unto the trustor, testator, or creator or vests in an advisory or investment committee or any other person or persons, including a cofiduciary, to the exclusion of one or more of the fiduciaries, authority to direct the making or retention of investments, or any investment, the excluded fiduciary or cofiduciary shall be liable, if at all, only as a ministerial agent and shall not be liable as fiduciary or cofiduciary for any loss resulting from the making or retention of any investment pursuant to such authorized direction. Va. Code § 26-5.2.

The court found that: “The trustee’s power to diversify, however, was limited by the express language of Article X of the trust instruments” which stated “investment decisions as to the retention, sale, or purchase of any asset of the Trust Fund shall likewise be decided by such living children or beneficiaries, as the case may be”. *Rollins*, *2.

- (b) Significance of the Decision. Like *Duemler*, the plaintiffs in *Rollins* argued that the trustee had a duty to keep them informed and to impart to them any knowledge affecting their interest in the trust. *Rollins* at *4. However, the court was not persuaded:

“The plain language of the instrument, however, clearly contradicts the beneficiaries’ argument. The beneficiaries, alone, had the power to make investment decisions. **The statute enacted by the General Assembly recognizes the basic principal (sic) that the court cannot hold a trustee, or anyone else, liable for decisions that it did not and could not have made.** The statute clearly applies in this instance and the beneficiaries have not stated a cause of action against the trustee for failing to diversify the trust assets. The demurrer is granted as it relates to all claims for failure to diversify”. *Rollins*, at *2. [emphasis added]

The court’s clear recognition of the intent and purpose of the directed trust statute and its firm ruling upholding the statute is a clear indication that Virginia courts will enforce directed adviser provisions in a trust instrument based on the statutory framework that permits them.

3. Trust Protector - Case Law. Perhaps because the concept of trust protector is so new in the United States or because cases are settled or are otherwise disposed of, there are few reported decisions dealing with the subject of fiduciary liability for an administrative trustee following the direction of a Trust Protector. There have been at least two Trust Protector cases in Delaware in which the author’s law firm was involved. One case is a matter of public record. The other was sealed by the court during the proceedings to protect the privacy of the parties.*2.

- (a) The Friedman Case. In *Friedman v. U.S. Trust Company of Delaware*, C.A. No. 20205 NC (2003 Del. Ch.), an elderly

California resident was the beneficiary of a credit shelter trust established in 1970 by his late wife. He was about to marry for the fifth time. All of the residuary trust assets were held in more than 25 limited liability companies. The resident's son persuaded his father to move the residuary trust to Delaware "for asset protection purposes" prior to the marriage. U.S. Trust Company of Delaware agreed to serve as administrative trustee. A routine proceeding was conducted in the Court of Chancery to have Delaware accept jurisdiction over the trust, recognize U.S. Trust Company of Delaware as the trustee, declare that Delaware would thereafter govern the administration of the trust and modify the trust to include direction adviser provisions including the appointment of the son as a Trust Protector. The father resigned as trustee of the residuary trust. The father and son had a falling out. The son informed the father that the son, as Trust Protector, was now in charge of all of the business assets held in the 25 limited liability companies. When the father realized he had lost control of the residuary trust assets, he filed suit in Delaware seeking to open the judgment transferring the trust situs and appointing the son as Trust Protector. The reformed trust document defined the role of the Trust Protector as follows:

The Trustee shall not exercise any of its rights, powers or privileges under the Trust, or take any action under the Trust ...except upon written direction of the Trust Protector.

- (b) The Ruling. The court was deeply concerned with certain procedural matters. In particular, no notice of the change of situs of the trust had been given to the father's other three children who were remainder beneficiaries of the trust. The court also struggled with the concept of a purely administrative trustee and the role of the Trust Protector as evidenced by the following excerpt from the transcript of a hearing before the court.

The Court: Trust Protector... sounds like a super hero, or something like that. Is that something under California law that's developed as a concept? ...Why do we need a trustee when you have the omnipotent-

Attorney: In this case, that's a good question. Virtually all of the powers are vested in [the son], as Trust Protector.

* * *

The Court then questioned the attorney for the Trust Company to determine how the father lost control of the trust assets in the process.

Trust Co.: We simply did not have any knowledge of those facts that created this. My client was a facilitator. And under these instruments, if they are to govern, we are Administrative Trustee... that's our limited role. We are at the direction of the Trust Protector.

The Court: You are not really - - you are almost a pure Administrative Trustee. Right?

Trust Co.: I would say we are a pure Administrative Trustee.

The Court: Not even a money managing trustee, or anything like that.

Trust Co.: That's correct.

Immediately following the hearing, the court opened and vacated the order appointing the son as Trust Protector and the trust company as Administrative Trustee. The action was stayed pending further proceedings. In the interim, the parties agreed to litigate their dispute in California where the trust had been administered for more than thirty years.

- (c) Significance of the Outcome. The court did not assess any liability against the corporate fiduciary and all of the corporate fiduciary's legal fees were paid by the trust.
4. Sealed Case. Little can be said about the second Delaware case involving a Trust Protector. The case is under seal. However, it involved an offshore asset protection trust moved to Delaware pursuant to the Delaware Qualified Dispositions in Trust Act by a Trust Protector. It was alleged that the beneficiary of the trust suffered from mental illness and the Trust Protector essentially directed the Delaware Administrative Trustee not to make any distribution to or for the benefit of the beneficiary

who the Trust Protector viewed as uncooperative. The beneficiary petitioned the Delaware court, which had jurisdiction over the Delaware Administrative Trustee, for the payment of approximately \$7,000 in certain past due bills and a stipend of only \$4,000 per month from a trust with a corpus that exceeded \$1 million.

- (a) The Ruling. The corporate fiduciary took the position that it could not make any distributions from the trust except upon direction of the Trust Protector. There was hostility between the Trust Protector and the trust beneficiary. The court urged the parties to resolve their differences by stipulation. At one point the court wrote:

“Dear counsel:

My in-box gives me an inclination that rationality might not be prevailing in this matter.

At the urging of the court, the parties entered into a stipulated settlement paying the beneficiary’s delinquent bills and establishing a \$4,000 monthly living allowance. It was stipulated that the Trust Protector would resign (as would the Delaware corporate fiduciary) and the trust would be transferred back to the offshore jurisdiction from which it came.”

- (b) Significance of the Outcome. No liability was assessed against the corporate fiduciary who served as a purely administrative trustee. All of the corporate fiduciary’s legal fees were paid by the trust.

5. Directed Trustee Protection. When a directed trustee is given a direction that is clearly a violation of the trust, or at least highly suspect, and the trustee believes complying with the direction may cause the trustee to engage in willful misconduct, the trustee has a remedy.

- (a) UDTA. Section 9(d) of the UDTA authorizes a directed trustee that has a reasonable doubt about its duty in these circumstances to “petition the [court] for instruction.”

- (b) Delaware. Similarly, 10 Del. C. §6504 grants certain fiduciaries the right to petition the Court of Chancery in these circumstances. The statute was expanded after the UDTA to include trust directors and now provides that a trustee, fiduciary, adviser, protector or designated representative may have a declaration of rights to direct

a trustee to do or abstain from doing any particular act in its fiduciary capacity. *Id.*

- (c) The Fischberg Case. *In The Matter of the Juan Carlos Fischberg Family Trust dated May 22, 2003*, C.A. no. 2527-N (February 22, 2007) (Transcript), Capital Trust Company of Delaware (“Capital Trust”) was directed by the trust protector of a Delaware Asset Protection Trust to distribute the trust assets to an offshore account for the trust beneficiary who was the Settlor’s wife. The Settlor and his wife were both under indictment by the State of New Jersey for health care fraud. New Jersey claimed the trust was funded with proceeds from a criminal enterprise and threatened to indict the trust company if it made the transfer.

Capital Trust filed a petition for instruction with the Court of Chancery and the State of New Jersey intervened in the Delaware proceeding. The matter was later resolved. There was no liability on the part of the Delaware corporate fiduciary for failing to follow the direction of the trust protector.

- J. Conclusion. The UDTA is an extraordinarily well drafted act. The drafting committee spent a great deal of time listening to the experiences of those who practice in states where directed trusts have been administered for decades. The committee took these experiences into account and meticulously crafted a well written uniform act.

The UDTA also validates a directed trust practice that has existed in Delaware for more than 100 years. Many trust practitioners questioned the validity of allowing someone who did not hold the title of trustee to direct a trustee’s discretionary exercise of trust powers. The UDTA affirms the use of directed trusts to promote settlor autonomy and the principle of freedom of disposition.