REAL PROPERTY, PROBATE AND TRUST LAW SECTION
THE FLORIDA BAR

TRUST LAW COMMITTEE MEETING

Thursday, May 24, 2007
2:30 p.m. to 4:00 p.m.

Westin Diplomat
Ft. Lauderdale, Florida
305 Conference Room
(Conference Call Info at page 2)

AGENDA

I. Call Meeting to Order

II. Administrative Matters:

A. Appoint secretary for minutes;

B. Introduction of members present

C. Approve minutes for February 22, 2007, meeting at Hutchinson Island Resort Marriott (pgs. 3-6)

D. Announcements

III. Specific Agenda Items:

A. Holding of legal title of entireties property in trust (Bruce Marger) (pgs. 7-8)

B. Republication of invalid trust by amendment (Barry Spivey) (pg. 9)

C. Proposed Trust Code amendments by Fla. Bankers Assoc. (Mark Middlebrook):

1. On Directed Trusts (pgs. 10-28)
2. On Statute of Limitations on Claims Against Trustees (pgs. 29-31)

D. Asset Preservation Committee Liaison report (Boyett/Wolf);

IV. Open Discussion

SAR:211799:1

RPPTL Trust Law Committee Conference Call Information

Thursday, May 24, 2007 @ 2:30 p.m.

Conference Call Dial-In Phone Number: 1-877-394-0659

PARTICIPANTS - Trust Law Committee

When conference call participants dial into the conference call system, they will be asked for the Conference ID number (**466752**). Participants should enter this number followed by the **#** sign. They will then be connected to the call.

The Florida Bar
Real Property, Probate & Trust Law Section

Trust Law Committee
Minutes of Meeting

Thursday, February 22, 2007
Hutchinson Island Resort Marriott
Hutchinson Island, Florida

Call to Order. The meeting was called to order by the Chair, Barry Spivey, at approximately 2:00 p.m.

Administrative Matters. The Chair appointed John Moran as secretary for the meeting. An introduction of the members present followed.

Attendance. The following members and guests were in attendance:

Members:
Barry F. Spivey (Chair)
Christopher W. Boyette (Co-Vice Chair)
Laura P. Stephenson (Co-Vice Chair)
Angela McClendon Adams
David J. Akins
William F. Belcher
David Dreyer
Neil R. Chrystal
Stacey Cole
John Crain
Martha Edenfield
Brian J. Felcoski
Robert W. Goldman
Deborah Packer Goodall
Russell Hale
Steven Hearn
William T. Hennessey
Joan Bradbury Kayser
Stephen P. Heuston
William R. Lane
Laird A. Lile
Bruce Marger
Mark Middlebrook
John C. Moran
Pamela O. Price
Deborah Russell
Jon Scuderi
Michael D. Simon
Michael P. Stafford
Bruce M. Stone
Donald Tescher
Richard White
Marjorie Wolasky
Jerome Wolf
Diana S. C. Zeydel

Guests:
Pete Dunbar

Approval of Minutes. The minutes of the September 28, 2006 meeting at the Gaylord Palms in Kissimmee, Florida were approved as read.

Announcements. The Chair reported that a seminar titled, "Drafting Trusts Under Florida's New Trust Code" presented by the Florida Bar CLE Committee and the RPPTL Section of the Florida Bar is scheduled for late April, 2007 in Tampa and Miami.

Holding of Legal Title of Entireties Property in Trust. The Chair called upon Bruce Marger, who appeared by telephone, to discuss whether trust property loses its entireties character by way of its inclusion in a trust. Mr. Marger prepared a White Paper that was distributed to the Committee. Mr. Marger reported that preparing revocable trusts for married persons usually involves severance of their entireties property into separate grantor trusts for each spouse. These self-settled trusts lose the creditor protection afforded to estates by the entireties as to creditors of only one spouse. Mr. Marger explained that separating such assets results in disparate trust values, as well as difficulties in investing and diversifying the asset portfolios.

Mr. Marger and Fletcher Belcher proposed a new statute that would authorize a transfer of tenancy by the entireties property to a joint revocable trust for the benefit of the husband and wife as tenants by the entireties. The proposed statute reads as follows:

> **F.S. 689.051 Trust interest owned by spouses.** --- A beneficial interest in a trust or an equitable interest in trust property owned by a husband and wife may be held as a tenancy by the entireties. This section is applicable only to trusts described in s. 737.201(34).

The Committee engaged in a discussion regarding this proposal. Several questions were raised, including: What effects would the terms of a trust have on this proposed section? How would title to the property be recorded? Would including entireties language in the deed and trust documents remedy this issue? What would protect the assets from creditors if the trust's beneficial interest were not 100% of the entireties property?

After discussing this matter, the Chair stated that he would appoint a few other people to work with Mr. Marger and Mr. Belcher on these issues. Further, the Chair stated that the Committee would likely need to work with the Family Law Section, the RPPTL Real Property Division, and as the Asset Preservation Committee in addressing this issue.

Proposed House Bill 743 – The Florida Bankers Association's Proposed Changes to the Florida Trust Code. The Chair called upon Russ Hale to discuss the Florida Bankers Association's (the "FBA") proposed amendments to the Florida Trust Code. A copy of the FBA's White Paper and House Bill 743 was distributed to the Committee.

Mr. Hale described the FBA's proposals as follows:

1. The FBA's proposal would amend s. 736.0808 to provide for the ability of a grantor to appoint trust advisors with limited duties and to protect the trustee from liability by virtue of the exercise by the trust advisor of its powers.

2. The FBA's proposal would permit for the clock to start running on the statute of limitations against a trustee when the trustee resigns, the trust terminates, or when the

beneficiary has actual knowledge of facts upon which a claim may be based. Further, the proposal includes a 10-year statute of ultimate repose for claims against a trustee that continues to serve.

3. The FBA's proposal deals with the language of s. 736.1011, which limits the enforceability of exculpatory clauses in trusts that are drafted, "or caused to be drafted," by the trustee. Such clauses are enforceable only if the clause is fair under the circumstances and its contents are adequately communicated to the settlor. The FBA's proposal would allow for the commercial trustee to furnish the language to the settlor's attorney in lieu of proving adequate communication of the language to the customer.

4. The FBA's proposal also contains various corrections described as technical, including (a) removing the language of s. 660.417(3)(b), which states that a fiduciary cannot sell to fiduciary accounts on terms less favorable than to other customers; (b) adding certain exceptions to the conflict of interest rule in the Florida Trust Code; (c) adding language making it clear that s. 736.802(5) is not the exclusive provision applicable to authorize affiliated investments; (d) moving "closed-end" funds under the umbrella of s. 736.0816(3) rather than s. 736.0802(5); and (e) addressing transition and classification issues in the new affiliated investment rules.

Brian Felcoski explained that the RPPTL Executive Council has approved opposition to House Bill 743. Mr. Felcoski stated that the FBA's proposal would have adverse effects on beneficiaries and referenced the RPPTL's Legislative Position Request Form, which was distributed to the Committee. In short, it is the RPPTL's position that the FBA's proposals are not good public policy, are contrary to the interest of beneficiaries, and that several of the changes described as being "technical" are in fact substantive.

Subsequently, the Committee engaged in a lengthy educational discussion regarding House Bill 743.

Distribution in Further Trust Pursuant to Discretionary Power of Principal Invasion. At the Trust Law Committee in September 28, 2006, the Committee approved s. 736.0411 – Trustee's power to invade principal in trust, drafted as amended. Although the proposed statute was approved, following the last meeting Bruce Stone made some additional proposed revisions. Diana Zeydel discussed the revised proposed legislation and distributed a copy of the updated version of s. 736.04117 to the Committee.

After discussion, Donald Tescher made a motion to adopt the updated version of s. 736.04117. The motion was seconded and unanimously approved. The proposed statute will be put in form for consideration by the Executive Council.

Republication of Invalid Trust by Amendment. The Chair addressed an inquiry by Jerome Strauss regarding whether a trust amendment executed with will formalities that specifically republishes a trust effectively "resurrects" the testamentary dispositions in an original trust document that was not signed with will formality. The Committee discussed the issue and agreed that a statutory amendment is advisable to bring the Florida Trust Code in line with the Probate Code. The Chair stated that he would select a person to draft a proposed statute for the Committee to consider at the next meeting.

Trawick Correspondence on F.S. 737.4032. The Chair addressed an issued raised by Henry Trawick regarding the nonjudicial modification of trusts pursuant to s. 737.4032(6). Mr. Trawick suggested that the references to the rule of perpetuities should be deleted. The Chair discussed the intent of the section (including s. 736.0412, which will replace s. 737.4032). After discussion, the Chair asked that anybody who sees a problem with the statute as drafted to send him an email, and that he would keep this matter under advisement.

Asset Preservation Trust Subcommittee. Jerome Wolf noted that a proposed amendment to s. 736.0505 to clarify the terms of claims of creditors is set for discussion in the Subcommittee.

Next Committee Meeting. Barry Spivey announced that the next meeting of the Committee would be held in Fort Lauderdale on May 24, 2007.

Adjourment. The meeting was adjourned at approximately 4:30 p.m.

John C. Moran
Secretary for the Meeting

PROPOSAL FOR TENANCY BY THE ENTIRETIES IN TRUSTS

STATUTORY PROPOSAL

That a new statute be adopted:

"689.051 **Trust interest owned by spouses.** –
A beneficial interest in a trust or an equitable interest in trust property owned by a husband and wife may be held as a tenancy by the entireties. This section is applicable only to trusts described in S.731.201(34)."

PURPOSE OF THE PROPOSAL

1. **Creditor Protection**. Property owned by husband and wife as a tenancy by the entireties cannot be severed by a creditor of only one of the parties during the marriage. Even in bankruptcy of one of the parties, tenancy by the entireties is exempt from creditors claims. The proposed statute will allow this creditor protection to extend to property held by the married couple in trust.

Snyder v. Dinardo, 700 So.2d 726 (2d DCS, Fla. 1997) applied tenancy by the entireties to an escrow account held by an attorney for the spouses consisting of proceeds of the homestead sale for the later purchase of a North Carolina home in the wife's name. The case does not discuss the equitable nature of the escrow account. This is the only Florida case found approving tenancy by the entireties in an equitable estate.

2. **Superior Estate Planning**. Revocable trusts are an essential part of sophisticated estate planning. They maintain privacy of the plan of disposition of assets , reduce costs by limiting the need for probate administration, and reduce the need for court interference through guardianship during the clients' lifetimes. However, due to uncertainty, attorneys will typically have the married clients divide their tenancy by the entireties assets into separate trusts created by each spouse or leave these assets outside of the trusts.

Tenancy by the entireties property will, on the death of one spouse, become the sole property of the surviving spouse. Another important tool of estate planning is to have the surviving spouse disclaim up to one-half of the property held by the entireties so that the disclaimed portion will be treated as the sole property of the deceased spouse. This will allow better funding of the estate tax applicable exclusion presently $2 million of the deceased spouse and avoid the disclaimed property being subject to estate taxation on the surviving spouse's death. But the disclaimed property is then subject to the claims of any creditors of the decedent and probate administration.

The statutory proposal would allow the disclaimed property to remain in the trust and avoid probate administration.

3. **General Planning Principles**. The proposed statute does not limit who can serve as trustee. The only statutory requirement is that the husband and wife be the only beneficiaries of the property interests held as tenancy by the entireties. Both real estate, as well as personal property, could be held in the trust. Even homestead should be includable in the trust.

At the last meeting of the Committee at Hutchinson Island, the Committee expressed a consensus that it would be desirable for the Florida Trust Code to contain a provision making it clear that a trust amendment executed with will formalities that specifically republishes a trust effectively "resurrects" the testamentary dispositions in an original trust document that was not signed with will formalities. The initial draft of such a statute, drawn from Probate Code sections 732.5105 and 732.511, is set forth below for purposes of discussion. Also, refer to section 736.0403 of the Fla. Trust Code.

737.04035 – Republication of revoked or invalid trust. If a revocable trust has been revoked, or if a revocable trust or its testamentary aspects are invalid by reason of improper execution of the trust, it may be republished and made valid either by its reexecution or by the execution of an amendment referring to the trust with the formalities required by this Code for the execution of trusts.

DIRECTED TRUSTS

Presented By

FLORIDA BANKERS ASSOCIATION TRUST DIVISION

December 15, 2006

The creator of a Florida trust may desire to confer upon a person other than the trustee one or more powers to manage assets, direct distributions, modify or terminate a trust. These powers are normally exercised by the trustee. Such provisions may be highly desirable when assets contained in the trust are not those within the management expertise of the trustee or when someone close to the family is in a better position to make distribution decisions. The provisions of the FTC are inadequate to address the interrelationship between the trust advisor so appointed by the creator of the trust and the trustee appointed by the creator. This proposal amends s. 736.0808 F.S. to provide for the ability of the grantor to appoint trust advisors with limited duties and to protect the trustee from liability by virtue of the exercise by the trust advisor of its powers.

Proposed Language

736.0808 Powers to direct.

(1) Subject to ss. 736.0403(2) F.S. and s. 736.0602(3)(a) F.S., the trustee may follow a direction of the settlor that is contrary to the terms of the trust while a trust is revocable. For purposes of this section, the acts of the settlor of a trust while the trust is revocable shall be treated as acts of a trust advisor.

(2) The terms of a trust instrument may confer upon a person, one or more powers and discretions of a trust advisor which may be exercised or not exercised, in the best interests of the trust, in the sole and absolute discretion of the trust advisor whose actions are binding on all other persons. A trust advisor may be granted the power to direct, consent to or disapprove any investment action of the trustee; any distribution of trust assets; and any modification or termination of the trust. For purposes of this section, investment actions of the trustee include acquisition, retention, purchase, sale, exchange, tender, encumbrance or other transaction affecting ownership or rights therein of trust property and the investment and reinvestment of principal and income of the trust.

(3~~2~~) If the terms of a trust confer on a person ~~other than the settlor of a revocable trust, the power to direct certain actions of the trustee~~ one or more powers and discretions of a trust advisor, 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~~. The trustee shall not be liable, either individually or as a fiduciary, for any loss that results from compliance with a direction of the trust advisor; for any loss that results from a failure to take any action that requires prior approval of the trust advisor if the trustee timely sought but failed to obtain that authorization; or for any failure to correct, address or pursue

redress against the trust advisor for any breach of trust or other act of the trust advisor in the exercise or failure to exercise the power of the trust advisor. The trustee is also relieved from any obligation to perform investment or suitability reviews, inquiries, or investigations or to make recommendations or evaluations with respect to any investments to the extent the trust advisor had authority to direct investment actions of the trustee.

~~(3) The terms of a trust may confer on a trustee or other person a power to direct the modification or termination of the trust.~~

(4) A person, other than a beneficiary, who holds a power to direct is presumptively a fiduciary who, as such, is required to act in good faith with regard to the purposes of the trust and the interests of the beneficiaries. The holder of a power to direct is liable for any loss that results from breach of a fiduciary duty.

(5) By accepting an appointment to serve as a trust advisor of a trust that is subject to the laws of this State, the trust advisor submits to the jurisdiction of the courts of this state even if investment advisory agreements or other related agreements provide otherwise, and the trust advisor may be made a party to any action or proceeding if issues relate to a decision or action of the trust advisor.

MEMORANDUM

TO: Executive Committee

FROM: Directed Trusteeship Subcommittee:
Holly Gyles
Joe La Ferlita
Mark Altschuler
Natalia Murphy
Susan Greenwald

DATE: January 9, 2007

SUBJECT: Proposal to Enact a New York Directed Trusteeship Statute

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INTRODUCTION

The Directed Trusteeship Subcommittee (hereinafter "Subcommittee") of the Estates and Trust Administration Committee of the New York State Bar Association proposes the enactment of a directed trusteeship statute to the Estates, Powers and Trust Law expressly authorizing the bifurcation of trustee investment responsibilities in New York trusts. The proposed statute would be a codification of the decision in the Matter of Rubin,[1] which recognized the ability by the settlor of the trust to bifurcate trustee investment responsibilities. Directed trusteeship statutes have been enacted in many jurisdictions thus providing an attractive legal environment for trusts and trust services. New York State has historically been at a disadvantage in competing for New York's and other states' trust business because of the inability to effectively delegate responsibility among trustees for management of the trust investments. We believe that the enactment of a directed trusteeship statute in New York, wherein an investment

[1] 172 A.D.2d 841 (1991)

SAR:211799:1

trustee will have sole responsibility for trust investments and an administrative trustee will be responsible for all other matters of trust administration, will result in a positive economic impact for New York State as well its trust companies.

DISCUSSION

A. PUBLIC POLICY CONCERNS SUPPORTING ENACTMENT OF A DIRECTED TRUSTEESHIP STATUTE

New York City plays an important role in the center of American finance especially for wealth held in personal trusts. There are 61 financial institutions in New York City that manage personal trusts. The range of services these financial institutions offer vary from advice on the use of trusts, to creating and funding trusts, to serving as trustee administering such trusts.

A recent study on New York's trust business found that while the trust business has continued to grow, New York's trust business has continued to erode.[2] It is possible that this shift could be due to a distribution of wealth as people move from New York to other states. However, with the amount of wealth that remains concentrated in New York City it seems reasonable to conclude that there are other factors at work which have caused the trust business in New York to decline.

Both the business world and the legal world are highly competitive and states are constantly competing for business as a revenue generator. Forum shopping, a popular term for "shopping" around for the most advantageous laws, is inherent in today's world. The trust business is no different as states enact trust laws to help them compete for trust business.

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[2] Appleseed, A Matter of Trusts: Preserving Jobs and Taxes in New York's Personal Trust Business, A Report to the Lower Manhattan Development Corporation, February 2005.

Many states have enacted "trust-friendly" laws in order to earn the title of being a "trust-friendly state." Some commonly known states include Delaware, South Dakota, Alaska and most recently New Hampshire. These states have enacted similar forms of trust laws which include, but are not limited to, favorable fiduciary state income tax, a repeal of the Rule Against Perpetuities, creditor protection statutes and directed trusteeship statutes. As discussed in Section C, there are numerous states that have enacted directed trusteeship statutes. To date, New York has not enacted any of these types of statutes, thus putting New York at a clear disadvantage for competing for trust business.

New York's trust law is premised on the fiduciary duty that a Trustee owes to trust beneficiaries. As discussed in more detail in Section D, New York courts have been known to hand down hefty damage awards to beneficiaries that have been harmed by a Trustee breaching this duty. To abide by this duty, New York Trust and Estate practitioners know that it is their duty to advise New York clients on the advantages of creating and situsing trusts in other jurisidictions. As a result, trust business that would have otherwise stayed in New York is instead leaving the state to go to other "trust-friendly" states. Not only is this happening with new trust business, but this is also happening with existing trusts. It is not uncommon for Trust and Estate practitioners to advise clients to change the situs of their New York trusts to a more "trust-friendly" jurisdiction so that better flexibility can be achieved and/or to reduce trust income taxes.

When trust business leaves New York, the state is negatively impacted in a number of ways. First and foremost, the loss of trust business means a loss of revenue.

When assets leave the state not only are investment yields on those assets lost, but so are the income taxes due on those investment gains.

To situs a trust in a particular state usually requires a trustee within that state of situs to be appointed. This means a loss of business for New York financial institutions that are in the trust business if they do not have a presence in the other states. In response to this, some New York financial institutions have opened trust offices in "trust-friendly" states to accommodate the business going there. This gives them the advantage to serve as trustee and keep the revenue that they would have otherwise lost. Although a number of institutions have established trust offices out of state so that they continue to remain competitive and grow revenue, this does not help New York recover lost investment yields and income taxes on the assets that are moved out of state.

Financial institutions opening offices in "trust-friendly" states negatively impacts jobs in NY for two reasons. First, less trust business means the need for less New York employees to administer such trusts. Second, financial institutions opening trust offices out of state most likely staff such offices with employees in those states.

As the Appleseed study points out, the loss of jobs in the trust industry impacts other industries as well. The study estimates "that for every 500 trust-industry jobs that are lost to other states, New York loses an additional 1,100 jobs in other industries – a total of $334 million in statewide economic output".[3] The loss of 500 trust industry jobs is translated into a loss of $16.4 million annually in state and local revenue.[4]

Bank representatives interviewed as part of the Appleseed study stated that "growth that would have otherwise occurred in NY is now going to Delaware". One

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[3] *Id*. at 18.
[4] *Id*. at 19.

executive stated that, "We're looking to add another team of trust administrators. [W]e're probably going to hire them in Delaware…" Another major bank whose trust business has remained fairly stable during the past five years reported that the size of its Delaware subsidiary has tripled.[5]

If New York wants to be competitive in the trust business, it needs to start competing with "trust-friendly" states by enacting similar "trust-friendly" laws. A first step would be to enact a directed trustee statute. Enacting such statute has many benefits. Not only would such a statute help keep and grow trust business, but it would keep and create jobs and generate revenue from in-state trust assets. An even more important benefit is to allow New York residents to take advantage of New York's robust trust law and the vast expertise and experience of New York's Surrogate Court Judges rather than forcing potential trust settlors to look to other jurisdictions to situs their trusts.

As discussed in more detail in Section B, the ability to bifurcate the trustee role is not a new concept to New York. The Second Department in the Matter of Rubin[6] has recognized that the Trustee role can be divided. This statute would only be a codification of a trust law principal already recognized under New York's common law.

B. NEW YORK'S COMMON LAW REGARDING DIRECTED TRUSTEESHIPS

The Second Department is the highest New York court to have seriously considered directed trusteeships. It did so in Matter of Rubin, a construction proceeding brought by a co-executor to determine the validity of a clause in a will that required the two co-executors, in the event they disagree, to (1) consult with two named individuals

[5] *Id*. at 11.
[6] 172 A.D.2d 841 (1991)

and (2) follow the named individuals' advice, which clause the co-executor/petitioner argued was an infringement upon her authority and an impermissible delegation of authority. The court affirmed a 1989 decision and order by Surrogate Radigan[7] "for the reasons stated by Surrogate Radigan at the Surrogate's Court".[8] Surrogate Radigan had denied the petitioning co-executors' motion for summary judgment.

At the outset, Surrogate Radigan distinguished (1) the situation in which an instrument requires a fiduciary to act under the direction of some named person or institution from (2) a delegation, which involves a fiduciary, as opposed to the testator or settlor, "assigning" the responsibilities he was charged with by the testator or settlor. The former is done according to the testator/settlor's plan and is within his right to "limit, qualify, or condition the authority granted to his fiduciary". The latter is done, to the extent he is able, by the fiduciary.

Surrogate Radigan held that the appointment of an executor or trustee can be qualified by limitations as to time, place, or subject matter. He stated that, with respect to situations in which an instrument directs the fiduciary to obey the advisor's decisions: (1) the fiduciary is generally required to obey the advisor and "will not generally be held liable for any losses unless the instructions given him are improper or in violation of fiduciary duties owing to the beneficiaries"; (2) the relationship between a fiduciary and advisor is that of a co-trustee or co-executor; therefore, the advisor is, in effect, a fiduciary; and (3) prior New York case law held that a court could not review the actions of an advisor "except perhaps upon proof of improper motive."

At least two other New York courts have acknowledged and cited Matter of

[7] 143 Misc.2d 303
[8] 172 A.D.2d 841 (1991)

Rubin, including: (1) the New York County Surrogate's Court (Surrogate Roth), in Matter of John D. Rockefeller[9] and (2) the Westchester County Surrogate's Court (Surrogate Brewster), in Estate of Harry Winston.[10] The latter case also cites several older, lower New York cases that have holdings along the same lines as Matter of Rubin, namely Matter of Langdon,[11] and Estate of Riker.[12]

Despite the existence of New York case law that upholds directed trustee/executor provisions, in practice, institutional fiduciaries have shown great reluctance in accepting appointment as either an advisor or primary fiduciary in situations in which the instrument appoints an advisor whose directions the primary fiduciary is required to follow. In part, this is because (1) only a handful of courts have passed on the issue, most of which are lower courts; (2) the Second Department is the only appellate court that has passed on the issue; (3) the Court of Appeals has not decided the issue, which means that other courts could find that such provisions are not enforceable; and (4) the limited case law that does exist leaves many questions unanswered.

C. STATUTORY TREATMENT OF DIRECTED TRUSTEESHIP BY OTHER STATES

The "directed trust" is becoming more commonplace in the United States and a number of states have in recent years enacted legislation recognizing them. The question, however, is not so much as whether a state's law recognizes the "directed trust" but rather what consequences attach to a trustee's acting (whether blindly or otherwise) on the

[9] NYLJ, 8/24/99, at p. 28, col. 2
[10] NYLJ, 12/24/90, at p. 33, col. 3
[11] 154 Misc. 252 (1935)
[12] NYLJ, 3/10/82

instructions received. To date, 15 states have endeavored to confer special protections upon the trustee who acts upon the instructions of the person authorized in the trust instrument to direct. Whether the individual who is authorized to direct the trustee is referred to as a trust advisor, trust protector or investment committee, "directed trusts" raise two other important questions: (1) is the individual who is authorized to direct the trustee considered a fiduciary, and (2) is that individual subject to the jurisdiction of the courts?

1. Liability of the Excluded Fiduciary

a. The South Dakota Rule:

The South Dakota statute relieves an excluded fiduciary from liability for any loss that results from either (1) compliance with the direction of the trust advisor; or (2) a failure to take any action proposed by an excluded fiduciary that requires prior authorization of the trust advisor if that excluded fiduciary timely sought but failed to obtain that authorization.[13] In addition, the excluded fiduciary is relieved from any obligation to perform investment reviews and make recommendations with respect to any investments to the extent the trust advisor had authority to direct the acquisition, disposition, or retention of any such investments.[14] New Hampshire enacted into law a similar rule effective August 2006[15] and Idaho did the same in 2005.[16] Although both Wyoming and Ohio have statutes that provide similar relief, the relief in both these states

[13] S.D. Codified Laws §55-1B-2
[14] S.D. Codified Laws §55-1B-5
[15] New Hampshire UTC §§564-B:12-1206-1207
[16] Idaho UPC §15-7- 501(2)

is a default rule. Both states provide for such relief only to the extent it is not inconsistent with the trust instrument.[17]

b. The Delaware Rule:

The Delaware statute provides that a fiduciary who is directed in the governing instrument to follow the direction of an adviser and acts in accordance with such a direction, shall not be liable for any loss resulting directly or indirectly from such act, except in cases of *wilful misconduct on the part of the excluded fiduciary*.[18] In addition, if the trust instrument requires the fiduciary "to make decisions with the consent of the adviser, then except in cases of *wilful misconduct or gross negligence on the part of the fiduciary (italics added),* the directed fiduciary is relieved from any liability "for any loss resulting directly or indirectly from an act taken or omitted as a result of such adviser's failure to provide such consent after having been requested to do so by the fiduciary".[19]

In one of the first cases to deal with the applicability of this statute, the Chancery Court in R. Leigh Duemler v. Wilmington Trust Company,[20] issued a bench ruling validating the statutory defense of 12 Del. C. §3313(b) in a breach of trust suit. Wilmington Trust Company was held not liable as trustee for its actions in the absence of wilful misconduct. Mr. Duemler, a sophisticated investment adviser, was designated in a trust agreement to direct Wilmington Trust with respect to all investments. The trust portfolio consisted of extremely risky assets that required very diligent monitoring. One

[17] See Wy. St. §§4-10-715 and 4-10-717 (stating "Unless the instrument states otherwise,...") and Ohio Rev. Code § 5815.25(D) (stating "..not apply if provisions in trust are inconsistent").
[18] 12 Del. C. §3313(b)
[19] Id. at (c)
[20] C.A. 20033, V.C. Strine (Del. Ch. Oct. 28, 2004)

of the trust's investments suffered a significant drop in value as a result of Mr. Duemler's failure to provide Wilmington Trust with any direction as to the investment after Wilmington Trust timely sent him the prospectus. The court stated that Section 3313 requires the investment adviser to make investment decisions in isolation, without oversight from the trustee. If the investment adviser cannot make investment decisions by himself, the Court stated that the role of the investment adviser would not work as the trustee would always "second guess" the investment adviser's decisions. Although the Court found Wilmington Trust was not in breach of its fiduciary duty, it did hold that Mr. Duemler breached his fiduciary duty as investment adviser of the trust.

Several states have similarly imposed some duty or standard that if breached would cause the directed fiduciary to be liable for breach of trust. Under Georgia's statute, the trust instrument cannot provide relief to a trustee for a breach committed in bad faith or recklessly or with reckless indifference.[21] However, an excluded trustee shall be liable, if at all, only as a ministerial agent, and not as a trustee for any loss resulting from making or retention of any investment pursuant to an authorized direction.[22] Pursuant to Virginia's Power to Direct statute, a directed trustee is to act in accordance with the directions unless the directions are "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".[23] Florida enacted a similar statute,[24] effective July 1, 2007 and Texas recently amended its

[21] O.C.G.A. § 53-12-194(a)
[22] *Id*. at (c)
[23] VA. Code §55-548.08
[24] Fl. Trust Code §736.0808

statute to provide likewise.[25] Interestingly, prior to 2006, the Texas rule was that an excluded fiduciary was not liable, either individually or as a fiduciary, for a loss resulting from the making or retention of any investment or other act pursuant to the direction of the authorized advisory. However, this is the current state of the law in Colorado.[26] Tennessee provides similar relief by requiring that the instructions be written.[27]

Unless the terms of the trust instrument which provides for a person to direct the trustee expressly direct the trustee to rely, or relieves the trustee from liability if he does rely, the law in Indiana imposes a "*duty to refuse* (italics added) to comply with any direction which he knows or should know would constitute a breach of duty owed by that person as a fiduciary".[28] On the other hand, Alaska's statute authorizing the appointment of an advisor provides that unless the trust instrument provides otherwise, the trustee is vested with all powers as fully and effectively as if an advisor were not appointed and the trustee is not required to follow the advice of the advisor.[29]

2. Liability of Person with Power to Direct

Most of the states that recognize directed trusts have also statutorily imposed a fiduciary obligation on the power holder. The power holder is deemed to be a "fiduciary" and is liable to the beneficiaries of the trust and to the designated trustee as if he or she were a designated trustee in relation to the exercise or nonexercise of such power or

[25] Texas Probate Code §114.003
[26] Col. Rev. Stat. §15-1- 307
[27] Tenn. UTC §§35-3-122 and 35-3-123
[28] Indiana Code §30- 4-3-9
[29] Alaska Stat. §13.65.375

authority.[30] Both South Dakota and Delaware, as well as Idaho, provide that the power holder is considered a fiduciary unless the governing instrument provides otherwise.[31] As discussed above, the Chancery Court of Delaware held in the Duemler case that the investment advisor did breach his fiduciary duty as investment adviser of the trust. The law in Alaska is the reverse of Delaware. Alaska's statute provides "unless the terms of the trust instrument provide otherwise...the advisor is not liable as or considered to be a trustee of the trust or a fiduciary when acting as an advisor to the trust".[32]

3. Subject to Court's Jurisdiction

A major obstacle surrounding the use of the directed trust is the fact that many investment advisory agreements require the parties to submit to arbitration. To what, if any, judicial control is the advisor subject? Only four states have dealt directly with this issue. The statutes in South Dakota, New Hampshire, Idaho and Wyoming all provide that by accepting the appointment to serve as a trust advisor or trust protector of a trust that is subject to that state's laws, the power holder submits to the jurisdiction of that state's courts "even if investment advisory agreements or other related agreements provide otherwise, and the trust advisor or trust protector may be made a party to any action or proceeding if issues relate to a decision or action of the trust advisor or trust protector".[33]

[30] Wash. Rev. Code § 11.100.30; Texas Probate Code §114.003 (c); Fl. Trust Code §736.0808 (4); Tenn. UTC §5-15-808 (d); VA. Code §55-548.08 (D); Wy. St. §§ 4-10-711 and 4-10-713; and New Hampshire UTC §564-B:12-1204
[31] S.D. Codified Laws §55-1B-4; 12 Del. C. §3313(a) and Idaho UPC §15-7- 501(4)
[32] Alaska Stat. §13.36.375(b)
[33] S.D. Codified Laws §55-1B-7; New Hampshire Code §564-B:12-1205; Idaho UPC §15-7- 501(7); and Wy. St. §4-10-714

D. REAL LIFE EXAMPLES OF THE NEED FOR A DIRECTED TRUSTEESHIP STATUTE

The trusteeship function has multiple facets. The trusteeship function customarily can be broken down into three distinct functions – the investment management function, the administrative function, which includes custody, record-keeping and tax preparation, and the independent trustee function, that is, having the power to sprinkle or withhold income and/or principal among a class of beneficiaries or a single beneficiary.

Often, a settlor wishes a corporate trustee to fulfill a specific limited role with respect to overall trust administration. For example, with respect to investment management, corporate trustees often are faced with situations in which settlors wish to avail themselves of multiple investment advisors. Sometimes, the settlor wishes the corporate trustee to have no role whatsoever in managing the trust investments. In these situations, it is understandable that the corporate trustee wishes to have no liability for the investments held in the trust for which it has no investment responsibility. However, New York's current statutory scheme - EPTL 11-2.3(c) - does not absolve a trustee from all liability in these circumstances.

In other situations, the trust holds either a single stock or concentrated stock position that the settlor and his or her family wishes to retain. This often times arises in the context of a family business. Despite careful drafting, corporate trustees in New York currently cannot be assured that the New York courts will not attempt to apply the prudent investor standard to a particular situation, irrespective of specific language permitting retention. In these instances, the corporate trustee does not wish to have any liability for investments. Clearly, in New York there is a need for a trusteeship vehicle

whereby multiple investment advisors may be utilized, with the administrative trustee having no investment responsibility.

Two well-known New York cases illustrate this point. The first, In re Janes,[34] involved the former prudent person rule. In Janes, the Will contained no specific retention language, but the corporate trustee believed that it was following the wishes of the beneficiaries in retaining a large block of Kodak stock. The Court of Appeals held that the prudent person standard does not automatically require diversification, but rather requires the Court to examine the facts and circumstances of each particular case. However, the Court held that lack of diversification might present an unreasonable risk to the trust assets. In Janes, the Court held the corporate trustee liable for failure to diversify and imposed a large damage award on the corporate trustee.

In Dumont,[35] the Will contained specific language requesting retention of a large block of Kodak stock, as the testator's family had an historical connection with this company. Despite the language contained in the Will, the Surrogate in 2004 held that the prudent person standard mandated diversification and imposed a large damage award in excess of $20 million. The Surrogate recently was reversed by the Appellate Division,[36] and the Court of Appeals has declined to hear a further appeal. Nevertheless, corporate fiduciaries in New York are not comfortable that the language in an instrument will absolve them from any investment liability absent statutory reform.

In situations where the trustee has a sprinkle power over income and/or principal, for tax purposes the trustee exercising this discretion must be independent, as that term is defined in the IRC and regulations promulgated thereunder. Although corporate trustees,

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[34] 90 N.Y.2d 41 (1997)
[35] Surrogate's Court Decision, File No. 1956 TT 443 (unpublished)
[36] Matter of Chase Manhattan Bank, 26 A.D.3d 824 (4th Dep't 2006)

by definition, are independent, often the settlor does not wish to place this power in the hands of an institution. Rather, the settlor may prefer a family friend or family member outside the eligible class, familiar with the family and wishes of the settlor, to hold this particular power.

As stated above, many settlors do not wish the corporate trustee to have investment responsibility or power over discretionary distributions, but do wish the corporate trustee to act as administrative trustee only thereby keeping the trust records, retaining custody of trust assets and preparing trust tax returns. To the extent that New York has a well developed and modern trust law, non-residents may wish to choose a New York corporate trustee to secure New York jurisdiction over their trusts, much as Delaware corporate trustees are today utilized.

It is the Subcommittee's belief that New York needs to enact a directed trusteeship statute in order to attract trust business from both New York residents and non-residents.

E. SUMMARY OF PROPOSED DIRECTED TRUSTEESHIP STATUTE

Section (a) of the proposed Directed Trusts statute is the definitional section of the statute. The Subcommittee believes that this section is very important given that some New York practitioners may be unfamiliar with the directed trusteeship concept. Subsections (a)(1) and (a)(2) define the roles of the investment trustee and the administrative trustee, thus preventing any misunderstanding as to the roles between the two fiduciaries. The investment trustee's role is to direct the administrative trustee as to investment decisions. The administrative trustee's role with respect to investment

decisions is to follow the investment trustee's direction. Subsection (a)(3) defines the term investment decision as it is used in the statute. Subsection (a)(4) makes it clear that the trustee role can be bifurcated in both inter vivos and testamentary trusts.

Subsection (b)(1) mandates that the investment trustee's direction to the administrative trustee must be in writing. This prevents the opportunity for any misunderstanding as to the scope of the investment direction given. It will also prevent a "he said/she said" argument at a later date.

Subsection (b)(2) states that the administrative trustee is not liable for any loss for following the direction of the investment trustee. Subsection (b)(3) states that the administrative trustee has no duty to review the actions of the investment trustee. Both subsections are premised on the Delaware statute and the reasoning in the Duemler case.[37] As the Duemler Court stated, if the trustee has the duty to "police" the investment trustee's investment decisions the role of the investment adviser would not work since his decision would always be subject to second-guessing. We wanted the New York statute to be clear that the administrative trustee has no duty to question the investment trustee's direction and the administrative trustee will not be liable for any loss when following such direction.

Section (c) provides that the investment trustee is a fiduciary and as such is liable for breach of that duty. The Subcommittee believes that it is important that the investment trustee be subject to liability for its decisions should the beneficiaries be harmed by any investment decisions or lack thereof. This helps ensure that the investment trustee guards his duty and does not engage in a speculative investment

[37] See Section C1b of this Memorandum

policy. Many states that have enacted a directed trust statute have imposed this fiduciary obligation on the power holder.[38]

Section (d) of the proposed statute mandates that when the investment trustee and the administrative trustee accept their appointments that they submit to the jurisdiction of the courts. This avoids any obstacle that may arise when an investment advisory agreement containing an arbitration clause is involved. This usually occurs when a corporate trustee is appointed.[39]

Subsection (e) refers to the commissions that the investment trustee and the administrative trustee are entitled to. Such commissions are pursuant to Article 23 of the Surrogate's Court Procedure Act. This allows flexibility that when a corporate trustee is appointed the fees can be negotiated between the parties as is always the case when a corporate trustee is appointed. It has been the experience of some Subcommittee members that when a corporate trustee is appointed as administrative trustee under a directed trust statute, for example in Delaware, that the corporate trustee will take a reduced commission to represent its reduced role and responsibility.

Section (f) states that the statute only applies to trusts that are created after enactment of the statute and which incorporate such statute by reference. This prevents any conflict as to the Directed Trusts statute being applied retroactively and makes it clear when the trust settlor intends to have the trustee role bifurcated, as trustee bifurcation will not be required in every trust situation.

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[38] See Section C2 of this Memorandum
[39] See Section C3 of this Memorandum.

STATUTE OF LIMITATIONS ON CLAIMS AGAINST TRUSTEES

Presented By

FLORIDA BANKERS ASSOCIATION TRUST DIVISION

December 15, 2006

The Florida Trust Code ("FTC") enacted by the Florida legislature largely re-enacts existing law as to the statute of limitations against a trustee. In what may be an important change in existing law, however, the section provides that where there is not adequate disclosure of the facts upon which a claim may be based, FTC provides that while the claim is barred as provided in Chapter 95 (normally a 4 year statute of limitations) the cause of action does not accrue (and correspondingly the limitations period does not commence) until the trust beneficiary has actual notice of the trustee's repudiation of the trust or adverse possession of trust assets. Under current law, the Florida Supreme Court has held that delayed discovery does not extend the statute of limitations in breach of fiduciary duties cases, which begins to run when the last element of the cause of action occurs. See, Davis v. Monahan, 832 So.2d 708 (Fla. 2002).

The Florida Bankers Association believes that while extension of the statute of limitations when there is not adequate disclosure is a reasonable trade off for a shortened statute of limitations when there is, a number of events other than repudiation of the trust and adverse possession of trust assets should also cause the time clock to begin. Those items are resignation of a trustee, termination of the trust, and actual knowledge of the beneficiary of the facts upon which the claim is based.

The Florida Bankers Association also believes it to be unreasonable for the extension of the statute of limitations to be open ended. Under the FTC, a trust may last for many generations. Adequate disclosure or not, there must be some period of ultimate repose for claims against a trustee that continues to serve. The Florida Bankers Association suggests that a 10 year statute of ultimate repose is a reasonable period beyond which no claim could be made.

Proposed Language

736.1008 Limitations on proceedings against trustees.—

(1) Except as provided in subsection (2), all claims by a beneficiary against a trustee for breach of trust are barred as provided in chapter 95 as to:

(a) All matters adequately disclosed in a trust disclosure document issued by the trustee, with the limitations period beginning on the date of receipt of adequate disclosure.

(b) All matters not adequately disclosed in a trust disclosure document if the trustee has issued a final trust accounting and has given written notice to the beneficiary of the availability of the trust records for examination and that any claims

with respect to matters not adequately disclosed may be barred unless an action is commenced within the applicable limitations period provided in chapter 95. The limitations period begins on the date of receipt of the final trust accounting and notice.

(2) Unless sooner barred by adjudication, consent, or limitations, a beneficiary is barred from bringing an action against a trustee for breach of trust with respect to a matter that was adequately disclosed in a trust disclosure document unless a proceeding to assert the claim is commenced within 6 months after receipt from the trustee of the trust disclosure document or a limitation notice that applies to that disclosure document, whichever is received later.

(3) When a trustee has not issued a final trust accounting or has not given written notice to the beneficiary of the availability of the trust records for examination and that claims with respect to matters not adequately disclosed may be barred, a claim against the trustee for breach of trust based on a matter not adequately disclosed in a trust disclosure document accrues when the beneficiary has actual knowledge of the facts upon which the claim is based, or actual knowledge of the trustee's resignation, repudiation of the trust, ~~or~~ adverse possession of trust assets or termination of the trust, and is barred as provided in chapter 95.

(4) Notwithstanding subsections (1) through (3), all claims by a beneficiary against a trustee shall be barred 10 years from the date of the act or omission of the trustee complained of.

(5) The failure of the trustee to take corrective action shall not be construed as a separate act or omission and shall not be construed to extend any period of limitations otherwise established by law, including but not limited to the limitations established by this section.

(6~~4~~) As used in this section, the term:

(a) "Trust disclosure document" means a trust accounting or any other written report of the trustee. A trust disclosure document adequately discloses a matter if the document provides sufficient information so that a beneficiary knows of a claim or reasonably should have inquired into the existence of a claim with respect to that matter.

(b) "Trust accounting" means an accounting that adequately discloses the information required by and that substantially complies with the standards set forth in s.736.08135 F.S..

(c) "Limitation notice" means a written statement of the trustee that an action by a beneficiary against the trustee for breach of trust based on any matter adequately disclosed in a trust disclosure document may be barred unless the action is commenced within 6 months after receipt of the trust disclosure document or receipt of a limitation notice that applies to that trust disclosure document, whichever is later. A limitation notice may but is not required to be in the following form: "An action for breach of trust based on matters disclosed in a trust accounting or other written report of

the trustee may be subject to a 6-month statute of limitations from the receipt of the trust accounting or other written report. If you have questions, please consult your attorney."

(75) For purposes of this section, a limitation notice applies to a trust disclosure document when the limitation notice is:

(a) Contained as a part of the trust disclosure document or as a part of another trust disclosure document received within 1 year prior to the receipt of the latter trust disclosure document;

(b) Accompanied concurrently by the trust disclosure document or by another trust disclosure document that was received within 1 year prior to the receipt of the latter trust disclosure document;

(c) Delivered separately within 10 days after the delivery of the trust disclosure document or of another trust disclosure document that was received within 1 year prior to the receipt of the latter trust disclosure document. For purposes of this paragraph, a limitation notice is not delivered separately if the notice is accompanied by another written communication, other than a written communication that refers only to the limitation notice; or

(d) Received more than 10 days after the delivery of the trust disclosure document but only if the limitation notice references that trust disclosure document and:

1. Offers to provide to the beneficiary on request another copy of that trust disclosure document if the document was received by the beneficiary within 1 year prior to receipt of the limitation notice; or

2. Is accompanied by another copy of that trust disclosure document if the trust disclosure document was received by the beneficiary 1 year or more prior to the receipt of the limitation notice.

(86) This section applies to trust accountings for accounting periods beginning on or after JulyJanuary 1, 2007,2008, and to written reports, other than trust accountings, received by a beneficiary on or after JulyJanuary 1, 2007.2008.