

Estate Planning

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Trust Protector

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EVALUATE AND DRAFT HELPFUL TRUST PROTECTOR PROVISIONS

Trust protectors can help to ensure that trusts are administered as the settlor intended, but the protector could need protection from the potential liability that accompanies the position.

***24** Trust protectors are no longer a feature of only offshore asset protection trusts. Now trust protectors are being used more and more in domestic trusts as well. The expansion of time that a trust can exist without violating the rule against perpetuities in many states is one reason to consider using trust protectors. A lot can change if a trust is to last for a hundred years or more. Appointing a trust protector (or in this case a series of trust protectors) is an excellent way to deal with those changes.

This expanded use of trust protectors leads to some interesting questions:

- Who should be appointed as trust protector?
- What powers should be given to them?
- Are a protector's powers fiduciary powers, and should they be?
- Assuming that fiduciary powers are involved, to what standard of conduct should the trust protector be held?
- What liability is there to a trustee who blindly follows the directions of a protector?
- If requested by a prospective trust protector to give an opinion as to whether to accept the position of trust protector, what advice should be given?

These and other questions are discussed below.

Brief history of trust protectors

Trust protectors are a relatively new addition to American trust law. The origin of trust protectors can be traced to offshore asset protection trusts. The primary purpose of such trusts was to protect the settlor from potential creditors. However, many settlors feared turning over complete control of their assets to foreign trustees. Appointing a trust protector provided settlors the peace of mind of knowing that someone would monitor the foreign trustee's administration of the trust, thereby ensuring that the trustee's actions complied with the settlor's wishes. Based on the success that protectors provided in offshore asset protection trusts, attorneys in the U.S. have started to incorporate them increasingly in domestic trusts.

Only a handful of states have enacted statutes dealing with trust protectors. [FN1] These statutes deal principally with the type of powers that can be given to a protector. The Uniform Trust Code (UTC) has not really addressed this topic other than for a brief section dealing with powers to direct. As will be explained below, a power to direct is only one type of power that a protector might possess.

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*25 What is a trust protector and why appoint one?

A trust protector has been described as ‘a person who is the holder of a power which when invoked is capable of directing a trustee in matters relating to the trust and in respect of which matters the trustee has discretion and includes a person who is the holder of a power of appointment or dismissal of trustees.’ [FN2] Most states have no definition for a trust protector but it is debatable whether most states’ courts would find that the holder of a power of appointment is a trust protector, particularly if the power can be exercised in the power holder’s favor. Notwithstanding the above definition, the Restatement (Third) of Trusts points out that no universally accepted meaning of a trust protector exists. Under the Restatement’s definition, ‘a protector is the holder of one or more powers capable of affecting what the trustees are to do with the trust property.’ [FN3]

One reason for appointing a trust protector is to make the trustee more accountable. [FN4] With a properly drafted trust protector provision, this accountability can be achieved without in any way diminishing the trustee’s status as the trust’s primary decision maker. A poorly drafted provision, however, might make the trustee more accountable—but accountable to the protector rather than to the trust beneficiaries. Such a provision could actually undermine the quality of the trustee’s decision making by increasing the trustee’s desire to please the protector, particularly if the protector has the power to remove the trustee. To counter this, the practitioner must draft the trust protector provision in such a way as to achieve this delicate balance between accountability on the one hand and preserving the trustee’s ability to do his or her job, free of unnecessary interference from the protector, in those instances in which the settlor wants to take advantage of the trustee’s expertise.

A settlor may have other reasons for wanting to appoint a trust protector. First, he or she might use a protector to deal with change. This could be a change of the tax laws or a change in the circumstances for which the trust was created. Another reason would be to correct any mistakes made in the initial drafting of the trust instrument.

Trust protectors vs. trust advisors

What is the difference between a trust protector and a trust advisor? One well-respected commentator on trust protectors has stated that there is none. [FN5] However, the Restatement (Third) of Trusts points out that a trust advisor’s powers usually pertain to powers over investment decisions and distributions decisions. [FN6] Trust protectors, on the other hand, in addition to having authority over investment and distribution matters, usually are granted broader powers, such as the power to amend or to terminate the trust.

South Dakota draws a distinction between a trust protector and trust advisor by limiting the term ‘trust protector’ only to power holders who are disinterested third parties. [FN7] In contrast, South Dakota law defines ‘trust advisor’ to include individuals who are clearly interested parties, such as settlors and beneficiaries who hold certain powers. For most purposes, however, the terms trust protectors and trust advisors are used interchangeably, although if the settlor’s intention is to give the power holder the power to amend or to terminate the trust, it is more accurate to refer to them as trust protectors.

Who to appoint as trust protector

The most important decision a settlor faces probably is who to appoint. Although almost anyone can serve, it is usually preferable to name some independent third party to this position. Otherwise, the settlor runs the risk of tax consequences either to himself or herself, his or her estate, or to the trust protector, depending on the type of powers granted.

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The most logical choices for trust protectors would be siblings of the settlor, aunts, uncles, the settlor's lawyer, accountant, or a close friend having good business judgment and background. Another option is a professional trust protector. Because of the conservative nature of corporate trustees, they are usually not a good choice to serve as *26 protector. Regardless of who the settlor chooses as his or her trust protector, however, another important determination that the settlor and his or her advisors must make is whether the person (or committee) being considered has the knowledge, experience, and most importantly the time necessary to carry out properly the duties and functions that the settlor needs them to perform. This is particularly the case if what is involved is a power over investments.

What powers to give the trust protector

A trust protector has no default powers. Any powers are purely the result of the powers conferred by the trust instrument. These powers are a matter of contract. Considering this aspect, a good trust protector provision is not something that can be incorporated into a few sentences as is sometimes the case. Each and every power that the settlor intends to provide needs to be clearly and fully spelled out in the trust instrument. General language is not suggested. Using specific language is the only guarantee that the protector will have the powers to the extent that the settlor intends.

A trust protector's powers generally fall into different classes or categories based on the aspect of the trust that the power affects. For example, certain powers relate to the supervision and monitoring of the actions of the trustee. These type of powers are usually drafted as powers to direct a trustee to do certain things, powers to veto a trustee's actions, or a trustee's powers requiring the consent of the protector.

A second category of powers would be powers to take action to deal with circumstances that the settlor either did not foresee or possibly could not have foreseen, such as changes in either the tax law or state law. These powers are usually drafted as powers to initiate action or as powers to direct the trustee's actions. Another class of powers would include powers to amend the administrative or dispositive provisions of the trust. These types of power are almost always drafted as powers to initiate action.

The specific powers that are given to trust protectors generally include one or more of the following:

- The power to remove, appoint, or add a trustee.
- The power to direct, veto, or consent to investments.
- The power to modify or amend the trust to achieve favorable tax status or to respond to changes in the tax law or state law.
- The power to add or delete beneficiaries.
- The power to terminate the trust.
- The power to direct, veto, or consent to trust distributions.
- The power to consent to, or modify the terms of a power of appointment granted by the trust.
- The power to change the situs or the governing law of the trust.
- The power to amend the trust as to administrative or dispositive provisions.
- The power to determine whether an event of duress has occurred.
- The power to approve accounts.
- The power to settle disputes between the trustee and a beneficiary or between two beneficiaries.

As evident from the above list, the trust protector's powers can take one of four different forms. They can be drafted as a:

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1 Direction (i.e., a power to direct someone to do something involving the administration of the trust or to make distributions from the trust).

2 Veto power.

3 Power to consent to the trustee's action.

4 Power to initiate change (i.e., such as a power to amend the trust or to remove the trustee).

Is a trust protector a fiduciary?

Whether a trust protector's powers are held in a fiduciary capacity depends on the state in which a client resides and how the power is drafted. In this respect, the Alaska statute states that a trust protector is not to be treated as either a trustee or a fiduciary. [FN8] On the other hand, the statutes of South Dakota, [FN9] Wyoming, [FN10] Idaho, [FN11] and Tennessee [FN12] all set forth the presumption that a trust protector is a fiduciary. In these later states, this presumption can be overcome by evidence to the contrary in the trust instrument.

UTC section 808 deals with 'powers to direct.' While this statute does not mention trust protectors specifically by name, it applies to any power to direct the trustee's actions. Subparagraph (4) of section 808 states that a person, other than a beneficiary, who holds a power to direct is presumably a fiduciary who, as such, is required to act in good faith with respect *28 to the purposes of the trust and the interests of the beneficiaries. The UTC, therefore, sets forth a legal presumption that powers to direct are fiduciary powers.

The Restatement (Third) also indicates that any powers held by third parties are presumably held in a fiduciary capacity. [FN13] However, that presumption can be overcome by providing otherwise in the trust instrument. It is suggested that in certain instances a settlor would want a trust protector's power to be held in a nonfiduciary capacity. Examples of such powers might be a power to direct discretionary distributions to beneficiaries or a power to remove a trustee. The settlor also might clearly want other powers to be held in a fiduciary capacity. The exercise of a power to direct which investments to purchase or to sell is almost certainly one of these powers. This is because as one writer has stated, 'No area of trust administration more directly affects the beneficiaries than the choice of investments to be purchased and retained by the trust fund. [FN14]

Recent case

McLean Revocable Trust v. Patrick Davis PC [FN15] is a recent significant case dealing with trust protectors. This is a Missouri Court of Appeals case that involved a trust protector who possessed the power to remove the trustee and appoint a successor trustee. As an aside, Missouri has adopted section 808 of the UTC, but this instance did not involve a power to direct. However, the trust specifically stated that the trust protector's authority to remove the trustee was 'conferred in a fiduciary capacity and shall be so exercised.' The primary issue the court faced was whether the trust protector had a duty to monitor or supervise the trustees. The protector argued that he had only those duties specifically set forth in the trust agreement and that those express duties did not include any duty to supervise the trustees or direct them to act in any particular manner.

The court pointed out, however, that '[o]ne who acts as a fiduciary assumes at least the basic duties of undivided loyalty and confidentiality.' Also, the court felt that a trust protector has at least some duty of care regarding the supervision of the trustees' actions, the exact extent of which the court did not clarify. Because the issue in this case was whether the lower court's granting of summary judgment was proper, the appellate court did not rule that the trust protector had breached his duty of care in this instance. Even so, this case should serve as a warning of how far a court might go when faced with a trust protector who does not exercise due care, not only with a power to remove the trustee, but with other powers as well. Also, this case points out the importance of

fully setting forth the duties of the protector in the trust instrument.

It has been previously recommended that a power to remove a trustee might be one of those powers that the settlor would want to designate as a nonfiduciary power. If the trust in this case had included such a designation, the trust protector would owe no duty of care.

Appropriate standard of conduct

One aspect of a trust protector provision that is often overlooked in drafting is the standard of conduct to which the trust protector should be held. This is unfortunate, because a well thought out, reasonable standard of conduct will go a long way in attracting and retaining a qualified trust protector.

Should the standard be the same that a trustee is held to or should it be something less? Since a protector's duties and responsibilities, like his or her powers, are a matter of contract, the answer to this question ultimately rests on what the settlor wants to provide in the trust instrument. Absent such a provision, there is the previously mentioned presumption under the UTC that a power to direct is held in a fiduciary capacity. [FN16] This is the default rule. Therefore, if the protector's power is drafted as a power to direct the actions of the trustee and assuming no indication of the settlor's contrary intent in the trust instrument, the trust protector must act in good faith with respect to the purposes of the trust and the interests of the beneficiaries. [FN17] This is the exact same standard of conduct to which the UTC states that a trustee is to be held. [FN18] Presumably, the standard of reviewing the trust protector's conduct should be the same.

The UTC further states that the holder of a power to direct is liable for any loss that results from a breach of a fiduciary duty. [FN19] This means that even ordinary negligence [FN20] (i.e., any breach of the trust protector's fiduciary duty, no *29 matter how small) in exercising or failing to exercise a power to direct would result in liability for any losses suffered by the trust. Contrast this with [section 808\(2\) of the UTC](#), which states that a trustee should obey the trust protector's directions (i.e., the trustee should refuse to obey only if the exercise is manifestly contrary to the terms of the trust or the trustee knows that the trust protector's exercise is a 'serious breach' of a fiduciary duty). Consequently, in theory at least, a situation could arise in which a court, on the one hand, would find a trust protector liable for his or her actions or inactions in connection with a power to direct and yet still rule that the trustee has an obligation to follow the trust protector's directions (because it was not a 'serious breach').

Is this default rule what the settlor wants? More importantly, is this the standard of conduct that a knowledgeable trust protector would be willing to work under considering the potential liability that might result? In many cases, the answer to both questions is likely to be 'no.'

Powers pertaining to management of the trust

What should the standard of conduct be when a trust protector possesses either a power to direct the trustee's management and administration of the trust (such as a power to direct investments) or a power to veto that management and administration? Professor Stewart E. Sterk, writing in the *Cardozo Law Review*, suggests that the typical settlor would have one of three possible expectations on how the trust protector should behave [FN21] (i.e., three alternate standards of conduct to which the settlor might want the protector to adhere) and that such expectation might vary depending on whether the protector chooses to exercise his or her power versus not exercising it:

- 1 The settlor might expect the protector to act the same way as a trustee would act under similar circum-

stances. Such an expectation is consistent with the legal presumption under the UTC for powers to direct (although it would not be with veto powers). The problem with this expectation, however, is that it makes the trust protector the primary decision maker for the trust thereby replacing the trustee in this role. [FN22] If the protector becomes the primary decision maker, then almost certainly the settlor would expect that the protector exercise the same degree of skill, care, and good judgment that a trustee would exhibit. Consequently, his or her liability should be the same as a trustee having similar powers.

2 The settlor might have no expectations on how the trust protector should act. The consequences of this expectation is that the protector would have *carte blanche* over the powers he or she has been given. The protector could and would act as he or she sees fit.

3 The settlor might want the protector to defer to the trustee's judgment in all situations other than those hopefully rare instances in which the trustee has abused his or her discretion. Another way of stating this expectation is that the settlor wants the protector to let the trustee do his or her job and to refrain from interfering unless the trustee's actions are so out of line that no reasonable protector would fail to take action when faced with the trustee's action or failure to act. Deference to the trustee's judgment is the anticipated behavior of the ideal trust protector under this expectation. [FN23]

Trust protector who chooses not to act. A trustee has a duty to be fully informed as to all relevant facts concerning the administration of a trust. [FN24] Furthermore, a trustee must carry out his or her responsibilities in an informed and considered manner and act as any ordinary prudent person would do in connection with the management of his or her affairs. [FN25] UTC section 808(4) provides that a trust protector is required to act in good faith with regard to the purposes of the trust and the interests of the beneficiaries. This is the exact same standard of care that a trustee is held to under UTC section 801. A trust protector, therefore, appears to have essentially the same duties that a trustee has regarding being informed and taking action when necessary to protect the interests of beneficiaries. [FN26]

***30** Considering the above, one reservation that any cautious individual (particularly an uncompensated individual) might have prior to agreeing to serve as a protector involves the possible liability that might be incurred if he or she erroneously fails to exercise a power to direct (or a veto power). UTC section 808(4) states that a person, other than a beneficiary, holding a power to direct is liable for any loss that results from breach of a fiduciary duty. If a protector fails to investigate and take action when he or she should have, potential liability for any loss arises just as if he or she acted improperly. [FN27]

Whenever a trust protector possesses either a power to direct or a veto power over the management and administration of the trust, most settlors would probably want the protector to defer to the trustee's judgment most of the time. [FN28] They would want the protector's role to be similar to that of a court. A court intervenes only when it has been made aware that a problem exists and is called on to intervene.

Concerning the protector's duty to investigate every aspect of the trustee's administration and management, considering the court analogy mentioned above, most settlors likely would not be overly concerned with a protector's failure to investigate every trust decision, even if it amounts to somewhat negligent behavior. The typical settlor would presumably want to apply a more deferential standard of review than that which is applied to a trustee. This assumes, of course, that the trust protector is not aware of a problem and chooses to do nothing.

Notwithstanding the leeway that a settlor might be willing to give to a trust protector who has failed to investigate a possible breach, the protector's inaction cannot rise to the level of reckless indifference or willful disregard to a possible problem about which he or she has knowledge. A protector would still be liable for his or her

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failure to act whenever the trust suffers a monetary loss and the protector (1) had made no reasonable inquiry into the trustee's behavior when he or she was aware there could be a problem, or (2) if no reasonable person would have failed to act (i.e., the trust protector by being recklessly indifferent is grossly negligent, or showing willful disregard for the beneficiaries' interests) under the facts available to the protector. [FN29]

Trust protector who takes affirmative action. Would the settlor want the same standard of conduct to apply if, instead of inaction, the trust protector chooses to take affirmative action? If the protector either directs the trustee to do something, vetoes a proposed decision by the trustee, or consents to a proposed decision of the trustee (when such consent is a necessary precondition to the exercise of the trustee's power), then the standard of conduct that a settlor would expect is likely to be different. [FN30]

For example, assume that the protector has the power to direct which investments to make. If he or she exercises this power and directs the trustee to purchase certain stocks, most settlors would want the protector to act with the same degree of care, diligence, skill, and good judgment that a trustee would exercise under such circumstances. A similar conclusion should also be reached if the protector exercises a power to veto or consents to a proposed action by the trustee. In these cases, the protector should arguably be held to the same standard of conduct that would be required of a trustee under similar circumstances and should be liable for any losses suffered by the trust.

Creating a workable standard of conduct and review. The standard of conduct that most settlors would want a trust protector to abide by when possessing either a power to direct or a power to veto the trustee's management and administration of the trust will vary depending on whether the protector acts or chooses not to act. If the protector initiates action, most settlors would want him or her to exercise the same care, skill, good judgment, and prudence of a trustee. If, however, he or she chooses to take no action, the trust protector would be liable for losses (his or her standard of review) only if the protector either made no reasonable inquiry, or even if a reasonable inquiry was made, if no other reasonable person would have failed to act under the facts available.

Such a standard, however, presents a potential problem. The protector can still face lawsuits alleging that the protector 'should have known' that the trustee was breaching his or her fiduciary duties and, therefore, should have made a reasonable inquiry. [FN31] To address this issue, a slightly different approach is suggested. Put the burden on the beneficiaries to *31 complain in writing about any potential breach of fiduciary duty. Under this alternate approach, unless a complaint was made, the protector would have no duty to investigate. Such an approach is more in line with the court analogy mentioned earlier. In most circumstances, a court acts only when a complaint is filed. Under this alternate approach, if the protector chooses to take no action, he or she would be liable for monetary losses (his or her standard of review) only if either (1) he or she made no reasonable inquiry when a beneficiary complained that an inquiry was warranted, or (2) even if a reasonable inquiry was made, no other reasonable person would have failed to take action against the trustee based on the facts revealed by that inquiry.

This alternate standard of review appears to permit somewhat lax or negligent behavior by the trust protector but not reckless indifference or willful disregard to the interests of the beneficiaries. This is a different and more deferential standard from that which applies to a trustee. With a trustee, the trustee is liable for simple negligence in failing to investigate when he either knew or should have known. [FN32] But that is the way it should be. A trust protector is not a trustee, and the protector's duties and liabilities are a matter of what the settlor wants to provide in the trust instrument.

If this is the standard of conduct (and the corresponding standard of review) that the settlor desires to impose on his or her trust protector, consider including the following provision:

Standard of Conduct and Standard of Review When Trust Protector Has Power Over Management and Administration Matters

The trust protector appointed hereunder shall have no duty to investigate the actions or inactions of the trustee, to audit the books and records of the trust, to monitor or review the investments of the trust or evaluate the performance of the trust portfolio, unless he or she receives a written complaint from either a trust beneficiary or some other interested party alleging a breach of trust and detailing which matters to investigate, audit, review, or evaluate.

If the trust protector appointed hereunder possesses either a power to direct the actions of the trustee in connection with the management and administration of the trust, or a power to veto a trustee's proposed action over the management or administration of the trust, then it is my specific intention that the trust protector defer to the judgment of the trustee regarding said management and administration, except in those instances in which the trust protector has been advised as provided in the preceding paragraph that the trustee might have breached his or her fiduciary duties. The trust protector shall intervene in only those instances in which he or she can find no rational basis for the trustee's actions, or failure to act, and the trust protector shall be liable for failing to act only if the trust suffers a monetary loss and (1) the trust protector made no reasonable inquiry when he or she was advised that the trustee might have breached his or her fiduciary duties, or (2) even if he or she did make a reasonable inquiry, no other reasonable person would have failed to take action against the trustee based on the information uncovered by that inquiry.

If, however, the trust protector, in matters relating to the management and administration of the trust, chooses (1) to exercise either a power to direct the actions of the trustee, or (2) exercises a power to veto the trustee's actions, or (3) consents to an action of the trustee that requires the trust protector's prior consent, then it is my intention that such powers be deemed to be fiduciary powers, and shall be exercised by the trust protector with the same degree of care, skill, competence, and good judgment that a trustee would exhibit in exercising such powers.

Powers over trust distributions

If the powers that the trust protector possesses relate to distributions from the trust, as opposed to powers over the trustee's administration and management of the trust, should the standard of review be any different? There are significant differences between these two aspects. Consider the standard of review that courts use in judging the conduct of trustees of total discretionary trusts as the appropriate standard when distributions are involved.

With a total discretionary trust, courts will typically sustain a trustee's exercise of discretion as long as the trustee can show some legitimate motive for his or her decision and no personal stake in the decision on whether to make a distribution. [FN33] A prerequisite to a court sustaining the trustee's decision, however, would be the requirement that the trustee actually exercise his or her discretion [FN34] (i.e., the trustee must consider the beneficiary's request, think it over seriously for a few seconds, and then in good faith decide one way or the other). In exercising this discretion the trustee must act honestly and with a proper motive. [FN35] Assuming that the trustee performs these minimum functions, however, a court will usually not second guess the trustee's decision of whether to make a distribution. This standard of review could likewise be applied to a trust protector who possesses a power over distributions or a power to terminate the trust.

Regarding the equating of a trust protector's powers over distributions to a trustee's exercise of discretion in a total discretionary trust, this point is crucial: The type of trust that the trust protector has the power over does

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not *32 necessarily have to be a total discretionary trust. The trust could be a trust providing simple discretion to make distributions for the health, support, education, and maintenance of the child. We are only equating the protector's standard of review to a trustee's standard of review over a total discretionary trust, not the type of trust involved.

Assuming that a settlor wants to use the above approach, consider the following standard of review for determining the trust protector's liability in connection with distributions from the trust:

Standard Of Review Of Trust Protector's Powers Over Distributions

If the trust protector appointed hereunder possesses a power to direct the trustee to make discretionary distributions and/or the amount of those distributions from the trust estate (including the power to terminate this trust), then the trust protector shall be liable for his or her actions or inactions, only if he or she acts in bad faith, is guilty of willful misconduct, or commits a crime. In connection with the above, however, the trust protector shall have an obligation to consider the request of any beneficiaries for a distribution from the trust and shall render his or her decision within a reasonable time frame.

Powers over other issues

Other powers given to trust protectors are neither monitoring powers, nor powers specifically dealing with distribution issues. A power of this type would be the power to change the situs of the trust for creditor protection purposes. This is an example of a power to initiate action. Other powers of this type include the following:

- A power to determine duress.
- A power to amend the trust because of changes in the law or because of a mistake in drafting.
- A power to remove the trustee.

Assume that an irrevocable trust includes a power that could cause the trust to be included in the settlor's gross estate for estate tax purposes at his death. A trust protector who has the power to amend the trust could delete the problematic power, thereby avoiding the estate tax inclusion. Most settlors, however, presumably would not want a trust protector who was unaware that this problematic power existed to be held liable for inaction. On the other hand, if the trust protector was aware of the potential adverse estate tax consequences, his or her choosing to take no action to amend the trust would amount to reckless indifference or willful disregard (i.e., gross negligence). In that event, most settlors would want the trustee to be held liable to the extent of the extra taxes incurred by his or her estate.

With these type of powers, most settlors probably would want the trust protector's standard of conduct to be similar to that which applies to a power to monitor the trustee's management of the trust. The only instance in which the trust protector should be held liable for simple negligence should be when he or she exercises the power and acts negligently. The settlor would expect nothing less in such a case. If, however, the trustee abstains from exercising the power, the settlor would probably want to impose liability only if the trust protector's failure to act rises to the level of reckless indifference or willful disregard of the interests of beneficiaries.

Designating protector's powers as personal powers

To this point, this article has proceeded under the assumption that the settlor wants the trust protector's powers to be held in a fiduciary capacity. In some instances, however, a settlor might not want a trust protector harassed with certain fiduciary duties. In that situation, he or she should consider designating such powers as personal powers. [\[FN36\]](#)

Designating a power as a personal power would turn a fiduciary power into a nonfiduciary power, thereby relieving the trust protector of the fiduciary duty of acting impartially (although not necessarily the duty of loyalty and the duty of acting in good faith). A personal power is a power given to an individual (and sometimes to a corporate trustee) based on the confidence that the settlor has in that particular individual. [FN37] With a personal power, the settlor is of the opinion that no one, not even a court, can exercise the power as well as this particular power holder. By designating the power as personal, the settlor intends to rely on the mere opinion or personal judgment of the power holder, whatever that judgment might be. Considering the significance that courts in most states place on carrying out the intent of the settlor, courts should be reluctant to overturn the decisions of the holders of personal powers.

Certain powers of a trust protector lend themselves to being designated as personal powers. Consider, for example, a power over distributions. A settlor might want *33 a trust protector to possess this type of power free from the duty of acting impartially. Another power that a settlor might want to designate as a personal power is the power to terminate the trust. Such a designation would permit the trust protector to favor remainder beneficiaries over current beneficiaries without having to worry about a lawsuit alleging that he or she had violated the duty of impartiality. A third power in this category is the power to remove the trustee. In this case, the settlor could permit the trust protector to act arbitrarily in this respect.

One power that a settlor might not want to designate as a personal power is the power to direct the trustee as to investments. As has been mentioned previously, most settlors would want a trust protector to be liable when he or she possessed this type of power and acts negligently. To make such a power a personal power would not be consistent with such a standard.

If a trust protector's power is designated as a personal power, liability would arise only if the power is exercised either in a dishonest manner, or when the exercise exceeds the scope of the protector's authority as set forth in the trust. For example, if the protector was given the power solely to approve distributions to beneficiaries, and he or she instead tried to direct the trustee as to investments, the attempted direction would be contrary to the terms of the trust and clearly be void. Similarly, a court would undoubtedly not tolerate a protector's accepting a bribe to induce him or her to terminate a trust, thereby benefitting the remaindermen over the current beneficiaries.

Potential liability of the trustee

No discussion of trust protectors would be complete without a look at the potential liability to which a trustee might be exposed for blindly following the directions of a trust protector. Notwithstanding the extent of a protector's powers that may be set forth in a trust, the UTC is perfectly clear that a trustee has a duty (*i.e.*, a *basic and fundamental duty*) to *administer the trust in good faith, in accordance with the trust's terms and its purposes and for the interests of the beneficiaries, and in accordance with the UTC.* [FN38] Compare this with [UTC section 808\(2\)](#), which requires a trustee to act in accordance with the exercise of a trust protector's power *unless the attempted exercise is manifestly contrary to the terms of the trust or the trustee knows that the attempted exercise would be a serious breach of a fiduciary duty that the trust protector owes to the beneficiaries of the trust.*

Assuming that the above statute is equating the phrase 'serious breach' to gross negligence, [FN39] in certain instances the exercise of a trust protector's power might be a serious breach of a fiduciary duty that the trust protector owes to beneficiaries. In such a case, the trustee must refuse to follow the trust protector's direction. For example, assume the trust protector had the power to direct investments and directed a corporate trustee to pur-

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chase one or two stocks (out of many the trust protector directed be purchased) that were on its non-approved asset list. Although that direction, by itself, 'might possibly' result in a monetary loss to the trust, it probably does not constitute a serious breach and, therefore, the trustee should obey the trust protector's direction.

However, if substantially all the stocks that the trust protector directed the trustee to purchase were on its non-approved assets list, then the attempted exercise of this power 'would probably and most likely' result in a monetary loss to the trust. Such an attempted direction would presumably be gross negligence and, therefore, would be a serious breach of the protector's fiduciary duty of due care owed to beneficiaries. In that event, the corporate trustee would have an obligation to oppose the direction. If the trust protector persisted, the trustee would be obliged to seek court intervention. [FN40]

Would the trustee's responsibility be any different if the settlor clearly provided in the trust instrument that the trust protector's powers are personal powers? Assume the same facts as in the preceding paragraph regarding the trust protector's directing investments in 'non-approved assets.' Does the trustee have a duty to do more in this instance? Although the protector has no fiduciary duty that has been breached under these circumstances, the trustee still has the fall-back fundamental duties under UTC sections 801 and 802(1) to administer the trust looking out for the interests of the beneficiaries. Following the trust protector's direction when it 'would probably and most likely' result in a monetary loss to the trust would *34 almost certainly be breaching that fiduciary duty.

If what is involved is a power to direct distributions (or a power to direct the termination of a trust), then the trustee's responsibility might be quite limited in connection with the trust protector's directions. This is because giving this type of power is akin to giving someone a power of appointment over the trust. With a power of appointment, as long as the attempted exercise is not contrary to the terms of the power, the trustee should not question the trust protector's exercise. In this respect, a settlor can waive a trustee's (and presumably a trust protector's) duty to act impartially, [FN41] and this is exactly what he or she has done by designating the power as a personal power.

As a guide to the trustee for following the directions of the trust protector, consider including in the trust a standard of conduct following [UTC section 808](#), such as:

The trustee shall act in accordance with the trust protector's exercise of his or her power except in those instances in which the directions are manifestly contrary to the terms of the trust or the trustee knows that the attempted exercise would constitute a serious breach of a fiduciary duty that the trust protector owes to the beneficiaries of the trust.

Is a consent provision desired?

Most of the above trust protector's powers, which relate either to directing the trustee's administration and management of the trust or powers over distributions, can be structured as requiring the trust protector's prior consent to the trustee's proposed action. For example, the trust could require a trust protector's consent before changing the portfolio alignment of the trust or before making discretionary distributions to beneficiaries.

This approach, however, has certain consequences:

1 Such a consent provision has the potential of paralyzing the efficient administration of the trust. If the trust protector is either unavailable (i.e., because he or she is retired and traveling abroad) or unwilling to consent, the only option available to the trustee is to seek court intervention. That is both costly and time consuming.

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2 A protector who possesses a power to consent is, for all practical purposes, nothing other than a co-trustee. [FN42] Does the settlor really want to make the trust protector a de facto co-trustee, considering the higher standard of conduct to which that would expose the trust protector—as well as increased liability for any losses suffered by the trust? Consider the potential extent of the trust protector's liability with a consent provision. The Restatement (Third) of Trusts provides that a power holder whose consent is a prerequisite for the trustee's action 'is liable for losses to the trust as a result of the power holder's breach of fiduciary duty whether as a result of improper exercise of the power or improper failure to exercise it.' [FN43]

If a settlor were to include a consent provision in the trust, it is reasonable to assume that most settlors expect the trust protector to review the trustee's proposed action with the same degree of care, skill, diligence, and good judgment that a co-trustee would exhibit in such a case prior to giving his or her consent. Further, would not a court, in dealing with a consent power, hold the trustee to the same high standard of conduct as a co-trustee? With this in mind, would not an uncompensated knowledgeable trust protector, recognizing the time necessary to fulfill properly his or her duties and the potential liability for even ordinary negligence, immediately resign?

For the reasons stated above, a settlor may prefer not to give the trust protector the power to consent to a trustee's action. Presumably, a settlor who designates a trust protector wants that trust protector to defer to the trustee's judgment most of the time. In essence, the settlor wants the trust protector to assume a role similar to that which a court would play. He or she does not want the trust protector to be a co-trustee. Therefore, rather than using a consent provision, it might be better to draft the power in some other form.

Limitations on trust protector's authority

The powers that are given to trust protectors should have certain limitations. For instance, every trust protector should be prohibited from appointing himself or herself, his or her spouse, any relatives, or any business associates as trustee. The trust should also provide that the trust protector cannot take any action that would directly or indirectly benefit the trust protector, his or her family, or anyone dependent on him or her.

The trust agreement should also prohibit the appointment of the settlor, the settlor's spouse, any trust beneficiaries, or any other person who has contributed property to the trust, as trust protector. The reason for prohibiting the appointment of someone who has contributed property to the trust as the *35 trust protector is because of the potential inclusion of part of the trust in that person's gross estate, which such a power of appointment might cause, under either Section 2036 or 2038.

Other limitations that should be placed in the trust agreement is language expressly prohibiting the trust protector from taking any action that would (1) disqualify any disposition to the settlor's spouse from the marital deduction, (2) disqualify any disposition from qualifying for the charitable deduction, or (3) cause the trust to be treated as a 'grantor trust' (assuming the settlor desires to avoid grantor trust status). Finally, the trust protector should be expressly prohibited from changing any part of the trust dealing with the powers, duties, and responsibilities of the office of trust protector.

Consider the following provision for a client who wants to guarantee qualification for the marital deduction:

Preservation of Marital Deduction

Notwithstanding anything in this trust agreement to the contrary, the trust protector shall not possess any power, authority, or direction that in any manner would limit or impair the benefits, rights, and powers necessary to qualify a trust created hereunder for the benefit of the settlor's spouse from qualifying for the marital deduction as defined in the Internal Revenue Code.

Multiple trust protectors

Settlors should try to anticipate which powers will most likely assist the protector in carrying out the trust's purposes and objectives, and bestow only those limited powers. Giving a trust protector very broad powers that attempt to address every potential future situation could be dangerous. For instance, should a trust protector who has been given broad powers to direct the trustee's investment decisions also be given the power to remove the trustee? That combination could encourage the trustee to be more responsive and accountable to the demands of the trust protector than to the interests of the beneficiaries. A better alternative could be to have someone who cannot direct the trustee's actions have the power to remove the trustee.

A settlor who nonetheless wants to bestow very broad powers should consider appointing multiple trust protectors and dividing the powers among them. As indicated previously, the settlor's intention in appointing a trust protector is not to take away the trustee's job as the primary decision maker of the trust.

Does the trust protector's power survive the death of the settlor?

Only a few states have enacted statutes dealing with trust protectors. At least one of those states, Wyoming, has felt the need to include in its trust protector statute a provision stating that the trust protector's power survives both the death and the incapacity of the settlor. [FN44] Other states have provided that the powers of a trust advisor (but not a trust protector) survive the death and incapacity of the settlor.

Although it is not being suggested that a trust protector's powers do not survive the death of the settlor (under the theory that a trust protector is an agent and agencies terminate on the death or incapacity of the principal), as pointed out previously, a trust protector's powers are purely the result of what is stated in the trust instrument. Consequently, the trust should specifically provide that the trust protector's power pass to successor trust protectors to avoid any questions.

Power to appoint a successor protector

Many trusts being created today are going to last for a very long time. In some states, a trust may be created that will last for up to 1,000 years without violating the rule against perpetuities. Assuming such a trust is created, many tax laws, trust laws, and circumstances can change during that time period. It would be prudent to include in the trust instrument some procedure for appointing one or more successors to the trust protector to deal with these changes.

The logical choice to appoint a successor is the current trust protector, possibly subject to the approval of the then current beneficiaries of the trust. Because a trust protector has no default powers, however, the procedure for appointing successors must be fully set forth in the trust agreement to be effective. One aspect of successor trust protectors that should be clarified in the trust is their fiduciary responsibilities. In this respect it will not be possible to designate any power bestowed on a successor trust protector as a personal power because the settlor has no personal relationship with the power holder. It would still be possible, however, to provide that some powers are deemed to be held in a nonfiduciary capacity. This should be done in appropriate cases.

*36 Should a trust protector be compensated?

A settlor who intends that the trust protector be given substantial duties and responsibilities should consider compensating him or her for those services. Particularly if the powers given to the trust protector are time-

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consuming and the issues are complex, the protector should be fairly compensated. Otherwise, the settlor runs the risk of getting what he or she pays for.

The trust protector's compensation amount and who should determine if it is reasonable are other questions that should be addressed. Clearly, how the trust protector should be compensated depends on the responsibility he or she has assumed. As indicated previously, there is substantial potential liability associated with certain powers given to the trust protector. If what the settlor wants is day-to-day monitoring on the trustee's administration of the trust, then the trust protector's compensation should be substantial. Further, if the power granted is to direct the investment decisions of the trustee, then the protector is a de facto investment advisor and should be compensated as such. Presumably, the trustee's compensation could be reduced somewhat in such a case as a result. Remember, however, that the trustee will still have responsibility for verifying the soundness of the trust protector's directions. The trustee also has potential liability for blindly following the directions of the trust protector, and this serves as a valid argument for not reducing the trustee's fees.

If the trust protector's only power is to direct the trustee as to discretionary distributions to beneficiaries or to terminate the trust, and if such powers are designated as personal powers, the trustee's potential liability should be minimal and his or her compensation should be little or nothing. Similarly, if the sole power given the trust protector is a power to amend the trust if there is a change in the tax law or state law, then this power would seldom be invoked and, therefore, the compensation should be minimal.

The trust could set forth either an hourly rate or monthly amount for the trust protector's compensation. Also, the settlor might want to provide that the trust protector's compensation must be approved by the individuals bearing the economic impact of these fees. If those individuals do not approve the fees, then some procedure involving an arbitrator or court approval should be provided. One situation to avoid is having the trustee determine the compensation of the trust protector while the trust protector has the power to remove the trustee. This combination would clearly not be in the best financial interests of the trust.

How are trust protectors viewed by corporate trustees?

One might think that corporate trustees would always be opposed to the inclusion of a trust protector. Yet, in some situations a corporate trustee should at worst be indifferent or at best actually be receptive to the inclusion of a trust protector. Consider, for example, the situation where the settlor wants to include a power to remove the trustee. Would the corporate trustee rather have beneficiaries that are entitled to discretionary distributions hold such a power, or would it prefer some independent third party with no axe to grind?

Also, assume the trust contains a provision permitting distributions to allow a beneficiary to start a business but requires a determination by someone that the beneficiary have the knowledge and work ethic to have a good chance of success. Most corporate trustees would not feel comfortable making such a determination. Appointing as trust protector a sibling of the settler—i.e., someone who has witnessed the growth and development of the beneficiary over the years—might be the welcomed choice for a party to make this determination.

Conclusion

How should an estate planner respond when retained by a client who wants advice as to whether he or she should do a friend a favor and agree to serve as his or her trust protector? Hopefully, this article has pointed out the wisdom of pausing before giving an answer. Serving as trust protector can be a lot of hard work and can subject the individual to substantial liability. Unless the trust protector provision is drafted to define clearly the trust

protector's duties and responsibilities, as well as the limits to potential liability for gross negligence or willful misconduct, an estate planner might want to recommend that the individual pass on the honor.

The devil is in the details. It is hard to find a statement that more accurately describes the problems in drafting a trust protector provision. If properly drafted, trust protector provisions can be a welcomed addition to any trust instrument. A poorly worded trust protector provision, however, will lead to much confusion, possible tax consequences, and substantial additional costs in administering a trust.

A poorly drafted provision might make the trustee more accountable—but accountable to the protector rather than to the trust beneficiaries.

Whether a trust protector's powers are held in a fiduciary capacity depends on the state in which a client resides and how the power is drafted.

A trust protector is not a trustee, and the protector's duties and liabilities are a matter of what the settlor wants to provide in the trust instrument.

One power that a settlor might not want to designate as a personal power is the power to direct the trustee as to investments.

Every trust protector should be prohibited from appointing himself or herself, his or her spouse, any relatives, or any business associates as trustee.

The logical choice to appoint a successor is the current trust protector, possibly subject to the approval of the then current beneficiaries of the trust.

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[FN1]. See [Idaho Code Ann. §15-7-501](#), [S.D. Codified Laws §§55-1B-1 to 55-1B-5](#), [Alaska Stat. §13.36.370](#), [Wyo. Stat Ann. §4-10-710-4-10-718](#), and [Tenn. Code Ann. §35-15-808](#).

[FN2]. [Nevis International Exempt Trust Ordinance 1995](#), section 9(1).

[FN3]. [Restatement \(Third\) of Trusts](#), section 64, page 470.

[FN4]. Sterk, 'Trust Protectors, Agency Costs, and Fiduciary Duty,' *27 Cardozo L. Rev.* 2761 (2006). In writing this article, this author has relied heavily on Professor Sterk's excellent article. Because of the depth and quality of his insights, there will be numerous references herein to that article.

[FN5]. Bove, 'The Trust Protector, Trust(y) Watchdog or Expensive Exotic Pet?,' *30 ETPL* 390 (August 2003). If all that Mr. Bove is saying is that all trust advisors are trust protectors, then this author agrees. However, if he is saying that all trust protectors are also trust advisors, then this author does not agree.

[FN6]. Restatement (Third) of Trusts, section 75, comments b through f., page 59.

[FN7]. S.D. Codified Laws §55-1B-1(2).

[FN8]. Alaska Stat. §13.36.370(d).

[FN9]. S.D. Codified Laws §55-1B-1(4).

[FN10]. Wyo. Stat. Ann. §4-10-711.

[FN11]. Idaho Code Ann. §15-7-501(b).

[FN12]. Tenn. Code Ann. §35-15-808.

[FN13]. Restatement (Third) of Trusts, section 64, comments b through d, page 471.

[FN14]. Trust Advisors, 78 Harvard Law Rev. 1230 (1965).

[FN15]. 283 SW3d 786 (Missouri, 2009).

[FN16]. UTC section 808(4).

[FN17]. *Id.*

[FN18]. See UTC section 801.

[FN19]. See UTC section 808(4).

[FN20]. For purposes of this article, the term ‘ordinary negligence’ refers to ‘that course of conduct which a reasonable and prudent person would know *might possibly* result in a monetary loss or other detriment to the trust.’

[FN21]. Note 4, *supra*.

[FN22]. *Id.*

[FN23]. *Id.*

[FN24]. *Brent v. Smathers*, 547 So.2d 683 (Fla. App., 1989).

[FN25]. See *United States v. White Mountain Tribe*, 537 U.S. 465 (2003).

[FN26]. See, e.g., *McLean v. Davis*, 283 SW3d 786 (Missouri, 2009).

[FN27]. Note 14, *supra*. See also Knecht, 'Trust Adviser: Boon or Booby Trap?', 94 *Trusts & Estates* 815 (1955).

[FN28]. Note 4, *supra*.

[FN29]. Note 4, *supra*.

[FN30]. Note 4, *supra*.

[FN31]. Note 14, *supra*; see also Scott, *Trusts* §185, at 1364-65 (2d ed. 1956).

[FN32]. *Id.*

[FN33]. *In re Trust A & B*, 672 NW2d 912 (Minn. Ct. App., 2004).

[FN34]. *Restatement (Second) of Trusts*, §187, comment j.

[FN35]. *Id.*

[FN36]. See Bove, *supra* note 5; see also, Tiernan, 'Personal Power Stops Second-Guessing of Trustee Decisions,' 38 *ETPL* 37 (May 2011).

[FN37]. See *Finch v. Wachovia Bank & Trust Company*, 577 SE2d 306 (N.C. Ct. App., 2003).

[FN38]. UTC section 801.

[FN39]. There is no universally recognized definition of what constitutes gross negligence for trust administration purposes. Consider, however, the following possible definition of gross negligence that has been drawn from automobile accident negligence cases: Gross negligence is the course of conduct that a reasonable and

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prudent person would know *would probably and most likely* result in a monetary loss or other detriment to the trust.

[FN40]. Even if a trust protector holds a personal power, the trustee still has the duty to verify that the trust protector is acting within the terms of the trust. Further, if the trustee receives information that the trust protector is acting dishonestly (i.e., the trust protector has accepted a bribe to favor one beneficiary over another), then notwithstanding the personal power, the trustee cannot act as the trust protector directs. The fact that the trust protector's direction is within the boundaries of his personal power would not absolve the trustee from his duty of acting in good faith and with undivided loyalty, which implies keeping the beneficiaries reasonably informed and refusing to make any distributions.

[FN41]. See [UTC section 105\(2\)](#). A trustee's duty to act impartially is a duty that the settlor can override by the terms of the trust. Presumably, this same rule would apply to trust protectors.

[FN42]. Note 4, *supra*.

[FN43]. See [Restatement \(Third\) of Trusts, section 75](#), item f., page 56.

[FN44]. [Wyo. Stat. Ann. §4-10-716](#).

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