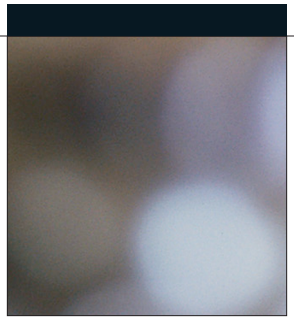

Directed Trusts: The Statutory Approaches to Authority and Liability

Allowing settlors to require that third parties will direct certain functions of the trustee allows a great deal of flexibility in planning by permitting multiple persons with different skills to handle the duties of trust administration.

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At common law, a trustee is held to the highest standard of fiduciary conduct. This means that a trustee is obligated to perform personally (without delegation) all acts of trusteeship, always preferring the interests of the beneficiaries over any competing interests. As the functions of trusteeship became more diverse and complex, however, it became clear that the prohibition on shifting trustee responsibilities to third parties could in fact harm beneficiaries because the trustee might lack the requisite expertise to handle competently all aspects of trusteeship. Accordingly, state legislation developed to allow trustees to delegate trustee duties, particularly investment decisions, and perform only an oversight function.

More recently, many states have enacted directed trust statutes that allow the trustor to appoint a third party to direct the trustee in carrying out certain duties of trusteeship. The extent to which the designation of an "advisor" who directs or prevents actions of the trustee exonerates the trustee from liability for following those directions varies from state to state. This article will review the approaches to authority and liability in a directed trust under the Restatements of Trusts (Second and Third), the Uniform Trust Code, and the statutes (or proposed statutes) of Alaska, Delaware, Florida, New York (draft), South Dakota, and Wyoming.

Background

The authority for directed trusts is generally derived from applicable state law. One common feature of the directed trust statutes is that the third party's authority to direct the trustee must be set forth in the trust instrument. Historically, there was some authority for directed trusts set forth in the Restatement of Trusts. The Restatements of Trusts (Second) and (Third) also require that the trust instrument contain directed trustee provisions. Section 185 of the Restatement (Second) of Trusts provides:

> § 185. Duty With Respect To Person Holding Power Of Control. If under the terms of the trust a person has power to control the action of the trustee in certain respects, the trustee is under a duty to act in accordance with the exercise of such power, unless the attempted exercise of the power violates the terms of the trust or is a violation of a fiduciary duty to which such person is subject in the exercise of the power.

Section 75 of the Restatement (Third) differs from the Restatement (Second) only slightly in that it requires the trustee to have knowl-

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edge or a reason to believe a violation of fiduciary duty has occurred:

> § 75. Effect Of Power To Control Acts Of Trustee. Except in cases covered by § 74 (involving powers of revocation and other ownership-equivalent powers), if the terms of a trust reserve to the settlor or confer upon another a power to direct or otherwise control certain conduct of the trustee, the trustee has a duty to act in accordance with the requirements of the trust provision reserving or conferring the power and to comply with any exercise of that power, unless the attempted exercise is contrary to the terms of the trust or power or the trustee knows or has reason to believe that the attempted exercise violates a fiduciary duty that the power holder owes to the beneficiaries.

The *Comments* to Restatement (Third) section 75 draw a distinction between powers held in a fiduciary capacity, and those that are held for the power holder's own benefit. The discussion echoes that in the Reporter's Notes on section 64 relating to trust protectors (a concept that is fundamentally quite similar to an advisor in that a trust protector may also have control over actions of the trustee or even the identity of the trustee) which also draws a distinction between a personal power that may be exercised for the personal benefit of the donee of the power and a fiduciary power which must be exercised for the purpose for which the settlor created it.

The Reporter's Notes on section 64 suggest that the broader the discretion of the power holder, the greater the power holder's fiduciary duties, so that if the power holder has "sole and uncontrolled discretion" that is "binding," then it would be appropriate to subject the power holder to the same fiduciary standards as a trustee. *Comment (c)(1)* to section 75 speaks in terms of a presumption that a power held by a person with special expertise, for example with respect to investments, would be held as a fiduciary, but a power given to a beneficiary, for example, to prevent the sale of a residence held in trust, would not be held in a fiduciary capacity. The Reporter's Notes on section 64 indicate that if the power holder's power is personal, then the trustee's only duty is to ascertain whether the attempted exercise is or is not within the terms of the trust.

Comment (b)(1) to section 75 states that a trustee has the duty to provide a power holder with information and an opportunity to respond relevant to the exercise of the power. *Comment (b)(1)* suggests that the power may be drafted to eliminate such a duty on the part of the trustee, putting the burden on the power holder to exert the initiative to acquit the power holder's duties. *Comment (f)* confirms that if the trustee may not act without the direction or consent of the power holder, then the power holder would be liable for loss resulting to the trust from a breach of a fiduciary duty as power holder, whether as the result of improper exercise of the power or improper failure to exercise it. Relevant to the failure of the power holder to act, however, is the trustee's duty to inform under *Comment (b)(1)*.

Uniform Trust Code

A more modern provision on directed trusts is contained in section 808

of the Uniform Trust Code, adopted by the National Conference of Commissioners on Uniform State Laws in 2003 (the "UTC"), a variety of which has been adopted in about 28 states. Section 808 provides as follows:

> § 808. Powers to Direct.
>
> (a) While a trust is revocable, the trustee may follow a direction of the settlor that is contrary to the terms of the trust.
>
> (b) If the terms of a trust confer upon a person other than the settlor of a revocable trust power to direct certain actions of the trustee, the trustee shall act in accordance with an exercise of the power unless the attempted exercise is manifestly contrary to the terms of the trust or the trustee knows the attempted exercise would constitute a serious breach of a fiduciary duty that the person holding the power owes to the beneficiaries of the trust.
>
> (c) The terms of a trust may confer upon a trustee or other person a power to direct the modification or termination of the trust.
>
> (d) 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.

The Comment to section 808 states that it ratifies the use of trust protectors and advisors. The Comment indicates that a power to direct is to be distinguished from a veto power because a power to direct involves action initiated by and within the control of a third party. That fact means the trustee usually has no responsibility other than to carry out the direction when made.

On the other hand, if the third party holds a veto power, the trustee is responsible for initiating the decision, and is in a position akin to a co-trustee with a duty to take action if the veto power is exercised in a manner that would constitute a serious breach of trust. Even in the case of a power to direct, however, the Comment confirms that a trustee has overall responsibility for seeing that the terms of the trust are honored, and thus may (and perhaps must) refuse to act if the trustee knows 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 owed by the holder of the power to the trust beneficiaries.

Trustee liability

The problem with the approaches taken by the UTC and Restatements of Trusts is that the trustee, who is presumably expected to take a back seat to the individual who is directing the trustee, must exercise a considerable amount of due diligence to comply with the trustee's continuing fiduciary obligations. The UTC does not relieve the trustee from liability for acting on the direction of another if the direction is "manifestly contrary to the terms of the trust or the trustee knows the [direction] would constitute a serious breach of a fiduciary duty that the [advisor] owes to the beneficiaries of the trust." A trustee under the UTC needs to do a number of things before it can act on the direction of another pursuant to the terms of the trust instrument: (1) confirm that the direction is not manifestly contrary to the terms of the trust, (2) determine what fiduciary duties the advisor owes to the beneficiaries, and (3) conclude that the trustee does not have knowledge that the direction would constitute a serious breach of the advisor's fiduciary duties.

The Comment to section 808 describes the supervision of the trustee over the actions of a power holder as "minimal oversight responsibility" and recognizes that "[p]owers to direct are most effective when the trustee is not deterred from exercising the power by fear of possible liability." Unfortunately, the Comment gives no examples that might clarify actions that would fall within the definition of a "serious breach of fiduciary duty" and others that would fall outside that definition. The Comment does, however, expressly acknowledge that the provisions of the section may be altered by the terms of the trust.

> The provisions of this section may be altered in the terms of the trust. *See* Section 105. [Section 105 contains mandatory and default rules under the UTC, but generally provides that the terms of the trust control.] The settlor can provide that the trustee must accept the decision of the power holder without question. Or a settlor could provide that the holder of a power is not to be held to the standards of a fiduciary. A common technique for assuring that a settlor continues to be taxed on all the income of an irrevocable trust is for the settlor to retain a nonfiduciary power of administration. *See* I.R.C. § 675(4).

It appears that if the holder of a power to direct is held to a fiduciary standard of conduct, the trustee's duty to evaluate the validity of the direction is ordinarily heightened. Therefore, there would appear to be a premium on ensuring that any clause conferring a power to direct clarify whether or not the power holder is to be held to a fiduciary standard. It would seem, under the UTC, that the trustee's liability for following the directions of the power holder can be reduced even below the "minimal standard" set forth in section 808, though perhaps not below a standard of good faith (see UTC

section 105 which prohibits a trust instrument from exonerating a trustee's duty to act in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries). Such exoneration should be considered if the settlor wishes to provide the trustee greater protection in accepting the role of a directed trustee.

A case in point is *Rollins v. Branch Banking & Trust Co. of Va.*,[1] in which the court applied the Virginia directed trust statute (which is identical to section 808 of the UTC). The court ruled that the trust instrument gave the beneficiaries the exclusive right to direct the investment decisions, and therefore the trustee could not be held liable for a failure to diversify. However, the trustee could not rid himself of his "duty to warn" the beneficiaries/advisors of any information that could affect the beneficial interests of the trust. The court expressly held that the directed trust statute "does not excuse a trustee from liability … for failing to attempt to prevent a breach of trust [by the advisor]."

The trustee's burden is even greater under the Restatements of Trusts. Both the Second and Third Restatements, in the case where the power holder is a fiduciary, put the burden on the trustee to confirm that the direction given by the advisor is not contrary to the terms of the trust or a violation of a fiduciary duty. Unlike the UTC, under the Restatements, a trustee can be liable if the direction does not comply with the terms of the trust, even if the inconsistency is not "manifestly contrary to the terms of the trust." In addition, there is no threshold as to the seriousness of the advisor's breach of a fiduciary duty before the trustee would be liable for following a direction that constitutes a breach.

It would seem, therefore, that the outcome under the UTC (in the case of a power holder who is nevertheless treated as a fiduciary) is much more consistent with the settlor's likely intention in drafting provisions that permit a third party to direct the actions of the trustee. The settlor's likely expectation is that the trustee would follow the directions of the power holder in nearly all cases, and that is the outcome the UTC seeks to achieve.

The UTC does carve out from a fiduciary obligation a beneficiary with a power to direct. But it would seem that the exception for direction by a beneficiary would not apply to a circumstance where the power to direct is not exclusive to the interests of the particular beneficiary in the trust, such as a power over investments in a trust with multiple beneficiaries or a power over distributions to others. Nevertheless, the Reporter's Notes on section 64 of the Restatement (Third) of Trusts suggest that a power of distribution held by a beneficiary might be akin to a power of appointment, in which case its exercise would not be subject to a fiduciary duty.

Directed trustee statutes

A number of states afford the directed trustee greater protection than the UTC or the Restatements.

Delaware

Delaware, for example, relieves a directed trustee from liability for any loss resulting directly or indirectly from following the direction of an "advisor" except in the case of "wilful misconduct." If, on the other hand, a fiduciary is to make decisions with the consent of an advisor, then the fiduciary is relieved of liability, except in cases of willful misconduct or gross negligence, for any act taken or omitted as a result of the advisor's failure to provide such consent after having been requested to do so by the fiduciary. The full text of the Delaware directed trust statute is as follows.

> 12 Del. C. § 3313. Advisors
>
> (a) Where 1 or more persons are given authority by the terms of a governing instrument to direct, consent to or disapprove a fiduciary's actual or proposed investment decisions, distribution decisions or other decisions of the fiduciary, such persons shall be considered to be advisors and fiduciaries when exercising such authority unless the governing instrument otherwise provides.
>
> (b) If a governing instrument provides that a fiduciary is to follow the direction of an advisor, and the fiduciary acts in accordance with such a direction, then except in cases of wilful misconduct on the part of the fiduciary so directed, the fiduciary shall not be liable for any loss resulting directly or indirectly from any such act.
>
> (c) If a governing instrument provides that a fiduciary is to make decisions with the consent of an advisor, then except in cases of wilful misconduct or gross negligence on the part of the fiduciary, the fiduciary shall not be liable for any loss resulting directly or indirectly from any act taken or omitted as a result of such advisor's failure to provide such consent after having been requested to do so by the fiduciary.
>
> (d) For purposes of this section, "investment decision" means with respect to any investment, the retention, purchase, sale, exchange, tender or other transaction affecting the ownership thereof or rights therein, and an advisor with authority with respect to such decisions is an investment advisor.
>
> (e) Whenever a governing instrument provides that a fiduciary is to follow the direction of an advi-

[1] 56 Va. Cir. 147, 2001 WL 34037931 (Va. Cir Ct., 4/30/01).

sor with respect to investment decisions, distribution decisions, or other decisions of the fiduciary, then, except to the extent that the governing instrument provides otherwise, the fiduciary shall have no duty to: (1) Monitor the conduct of the advisor; (2) Provide advice to the advisor or consult with the advisor; or (3) Communicate with or warn or apprise any beneficiary or third party concerning instances in which the fiduciary would or might have exercised the fiduciary's own discretion in a manner different from the manner directed by the advisor.

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

The Delaware statute reduces to a minimum the liability of a fiduciary who follows the direction of an advisor, exonerating as well the duties to monitor or advise the advisor and the duty to warn beneficiaries of potentially improper conduct by the advisor. The Delaware statute was applied in *Duemler v. Wilmington Trust Company*,[2] when a Delaware vice-chancellor ruled that the corporate trustee was not liable for the failure of the trust's investment advisor to give a direction, when the corporate trustee had in fact forwarded information relevant to the investment decision to the advisor, even though it was not received by the advisor.

In concluding that the trust company was entitled to a section 3313(b) defense (under 12 Del. C. § 3313(b)), the vice-chancellor held that it was not necessary for him to rest his conclusion on a release or other defense. The vice-chancellor focused on a number of facts in coming to this conclusion, including the fact that the trustee was not hired and not compensated to render investment advice, and the advisor (who was also a beneficiary) would have complained if the trustee had attempted to interject itself into investment management. The vice-chancellor concluded that there was "absolutely no evidence of willful misconduct" (the standard set forth in the statute for determining liability) and further stated that holding the trustee liable because it failed to make sure that the advisor directing the investment knew what he was doing would "gut the [directed trust] statute."

Florida

The Florida legislature recently passed an amendment to Florida Statutes § 736.0703 intended to relieve the directed trustee of liability for acts done in reliance on the direction of a co-trustee having the authority to direct it in the trust document. Florida's approach differs from the Delaware approach and the approach in the UTC in that it permits a directed trust only if the person giving the direction is also a trustee. The bill revises Florida Statutes § 736.0703 by adding a new subparagraph (9) as follows.

Amendment to Fla. Stat. § 736.0703. Cotrustees.

(9) If the terms of a trust instrument provide for the appointment of more than one trustee but confer upon one or more of the trustees, to the exclusion of the others, the power to direct or prevent certain actions of the trustees, then the excluded trustees shall act in accordance with the exercise of the power. Except in cases of willful misconduct on the part of the directed[3] trustee of which the excluded trustee has actual knowledge, an excluded trustee shall not be liable, individually or as a fiduciary, for any consequence that results from compliance with the exercise of the power, regardless of the information available to the excluded trustees. The excluded trustees shall be relieved from any obligation to review, inquire, investigate or make recommendations or evaluations with respect to the exercise of the power. The trustee or trustees having the power to direct or prevent actions of the trustees shall be liable to the beneficiaries with respect to the exercise of the power as if the excluded trustees were not in office, and shall have the exclusive obligation to account to and to defend any action brought by the beneficiaries with respect to the exercise of the power.

The significant difference between the approach in the amendment to the Florida statute and the approach of other states is that only a co-trustee may act as a "director," thus subjecting the co-trustee with the power to direct to full liability as a fiduciary. Presumably, the governing instrument could, however, relieve the trustee with authority to direct from liability for breach of trust except for bad faith and reckless indifference to the purposes of the trust or the interests of the beneficiaries consistent with Florida Statutes § 736.1011(1)(a). This should be distinguished from the authority contained in Florida Statutes § 736.0808 where the power to direct the trustee does not completely exonerate the directed trustee from liability for following the direction, but the person giving the direction is limited to a fidu-

[2] C.A. No. 20033, V.C. Strine (Del. Ch., 11/24/04).

[3] The reference to "directed trustee" appears to be an error because the directed trustee and the excluded trustee are the same person.

ciary standard of "good faith," rather than being subject to liability as a trustee.

The original bill did not include the language, "Except in cases of willful misconduct on the part of the direct[ed] trustee of which the excluded trustee has actual knowledge, ..." Surprisingly, it is not the directed trustee that is held liable for his or her own "willful misconduct" as in Delaware. Instead, the directed trustee must test the malfeasance of the directing trustee. This may present an interesting challenge for the directed trustee because the directed trustee must in effect test the state of mind of the directing trustee to determine if intentional misconduct has taken place. One wonders how the directed trustee will make such a determination. The "actual knowledge" requirement might mean that the directing trustee would have to articulate an intention to commit malfeasance regarding the trust before the directed trustee could be held liable. On the other hand, in its practical application the two tests may yield the same result. If the direction is a blatant violation of the terms of the trust, the directed trustee would likely be deemed to have engaged in willful misconduct upon following the direction, and the directing trustee would likely be deemed to have engaged in willful misconduct by giving such a direction.

New York

Draft legislation from the Directed Trusteeship Subcommittee of the Estates and Trust Administration Committee of the New York State Bar Association embodies the concept of a directed trust but only as to investment decisions by permitting the appointment of an "investment trustee," who would have exclusive authority to direct investment decisions and by exonerating any "administrative trustee" who must follow the investment decisions of the investment trustee from liability for those decisions. The proposed New York legislation is similar to the Florida proposed legislation in that it expressly deals only with directions by a co-trustee.

The draft New York legislation was intended to be a codification of the decision in *Matter of Rubin*.[4] In that case, the decedent provided in a codicil to his will that if the co-executors, son and daughter, should ever disagree with respect to the administration of the estate, they were to consult two named individuals whose direction they were to follow, provided the advisors agree. If the advisors could not agree, a court was to decide the matter. The particular issue in the case was the management of five parcels of commercial property owned by the decedent and his son. The son requested a direction from the advisors that the son be given exclusive management of the properties after the decedent's death because of his unique qualifications, and the advisors agreed. The daughter sued to have the clause in the codicil held an invalid infringement and impermissible delegation of her authority as a co-executor. The court held:

> Since the relationship between the fiduciary and the advisor is that of a cotrustee, with the advisor having the controlling power, the fiduciary is justified in complying with the directives and will not generally be held liable for any losses unless the instructions given him are improper or a violation of fiduciary duties owing to the beneficiaries.

Accordingly, the court ruled the designation of advisors to be a valid limitation on the powers of the executors. The court noted the decision in *Matter of Sanford*,[5] where the will exempted the executors and trustees from liability for any investment or any other action taken by them with the consent of the decedent's son, who was a beneficiary. The will restricted investments to obligations of the United States or the state of New York.

The court held that any investments beyond those authorized were regulated by the son, and the executors and trustees were automatically exempt from liability in carrying out his instructions. But see *Matter of Langdon*[6] (provision in decedent's will that differences of opinion between the fiduciaries would be resolved by the decedent's sister would not relieve the corporate fiduciary if fraud or gross negligence were present, and the corporate fiduciary would be required to seek court instructions in that event).

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4 143 Misc. 2d 203 (Surr. Ct. Nassau Cty.), *aff'd* 172 A.D.2d 841 (1991).

5 149 N.Y.S.2d 500 (N.Y. Supreme Ct., 1956).

6 154 Misc. 252 (N.Y. Surr. Ct. Westchester Cty., 1935).

Under the draft New York legislation, the investment trustee, who is defined as the trustee who has the authority to direct investment decisions, is solely responsible for investing the trust estate and directing the administrative trustee as to investment decisions. To avoid continuing fiduciary liability on the part of the administrative trustee, the proposed statute requires the administrative trustee to comply with the directions of the investment trustee and exonerates the administrative trustee from liability for any loss resulting from following the investment trustee's direction.

> EPTL Section 11-2.2A. Directed Trusts
>
> (a) As used in this section:
>
> (1) The term "investment trustee" means a trustee whose appointment is provided by the terms of the trust instrument and who has authority to direct investment decisions.
>
> (2) The term "administrative trustee" means a trustee whose appointment is provided by the terms of the trust instrument and whose sole responsibility with respect to the investment of trust funds is to follow the written direction of the investment trustee. The administrative trustee shall possess all powers and duties granted to a trustee other than the powers and duties affecting the investment decisions.
>
> (3) the term "investment decision" means retention, purchase, sale, exchange, tender or other transaction affecting the ownership of trust property.
>
> (4) The term "trust" means any express trust of property, created by a will, deed or other instrument, whereby there is imposed upon a trustee the duty to administer property for the benefit of a named or otherwise described income or principal beneficiary, or both. A trust shall not include trusts for the benefit of creditors, resulting or constructive trusts, business trusts where certificates of beneficial interests are issued to the beneficiary, investment trusts, voting trusts, security instruments such as deeds of trust and mortgages, trusts created by the judgment or decree of a court, liquidation or reorganization trusts, trusts for the sole purpose of paying dividends, interest, interest coupons, salaries, wages, pensions or profits, instruments wherein persons are mere nominees for others, or trusts created in deposits in any banking institution or savings and loan institution.
>
> (b) Except as otherwise provided by the express terms and provisions of a trust instrument within the limitations set forth by section 11-1.7 of this chapter:
>
> (1) the investment trustee is solely responsible for investing the trust funds by directing the administrative trustee in writing as to the investment decisions of the trust funds held by the administrative trustee;
>
> (2) the administrative trustee shall comply with the written directions of the investment trustee and if the administrative trustee acts in accordance with such directions, the administrative trustee shall not be liable for any loss resulting from any action or inaction of the investment trustee; and
>
> (3) The administrative trustee shall have no duty to review the actions of the investment trustee when the investment trustee has authority to direct the investment decisions.
>
> (c) The investment trustee is a fiduciary and the provisions of this chapter applicable to the trustees shall be applicable to the investment trustee, but only to the extent of the powers, duties and discretions granted to the investment trustee.

An open question regarding the New York draft legislation appears to be whether an investment trustee may be designated exclusively with respect to one or more assets or classes of assets, as opposed to having authority over the investment of the entire trust estate.

It appears that the reasoning behind the statute in Florida and the proposed statute in New York is that relieving liability as to a directed trustee is not as harsh a result for the trust beneficiaries if the advisor who directed that trustee is also a trustee (and thus can be sued independently for its own negligence or bad acts made in its fiduciary capacity).

South Dakota

The South Dakota statute would seem to be a blend of these ideas because it relieves the directed trustee from liability and at the same time designates the advisor (who need not be a co-trustee) as a "fiduciary" for trust law purposes. The South Dakota statute contains particular provisions dealing with investment functions and distribution functions, apparently on the theory that these are the types of functions a typical settlor may wish to have controlled by a person other than the trustee.

> S.D. Codified Laws 55-1B-1. Definition of terms (*selected subsections)*
>
> (5) "Excluded fiduciary," any fiduciary excluded from exercising certain powers under the instrument which powers may be exercised by the grantor, custodial account owner, trust advisor, trust protector, trust committee, or other persons designated in the instrument;
>
> (6) "Investment trust advisor," a fiduciary, given authority by the instrument to exercise all or any portions of the powers and discretions set forth in § 55-1B-10;
>
> (7) "Distribution trust advisor," a fiduciary, given authority by the instrument to exercise all or any portions of the powers and discretions set forth in § 55-1B-11;
>
> 55-1B-9. Investment trust advisor or distribution trust advisor provided for in trust instrument. A trust instrument governed by the laws of South Dakota may provide for a person to act as an invest-

ment trust advisor or a distribution trust advisor, respectively, with regard to investment decisions or discretionary distributions.

55-1B-10. Powers and discretions of investment trust advisor. The powers and discretions of an investment trust advisor shall be provided in the trust instrument and may be exercised or not exercised, in the best interests of the trust, in the sole and absolute discretion of the investment trust advisor and are binding on any other person and any other interested party, fiduciary, and excluded fiduciary. Unless the terms of the document provide otherwise, the investment trust advisor has the power to perform the following: (1) Direct the trustee with respect to the retention, purchase, sale, or encumbrance of trust property and the investment and reinvestment of principal and income of the trust; (2) Vote proxies for securities held in trust; and (3) Select one or more investment advisors, managers, or counselors, including the trustee, and delegate to them any of its powers.

55-1B-11. Powers and discretions of distribution trust advisor. The powers and discretions of a distribution trust advisor shall be provided in the trust instrument and may be exercised or not exercised, in the best interests of the trust, in the sole and absolute discretion of the distribution trust advisor and are binding on any other person and any other interested party, fiduciary, and excluded fiduciary. Unless the terms of the document provide otherwise, the distribution trust advisor shall direct the trustee with regard to all discretionary distributions to beneficiaries.* * *

55-1B-2. Liability limits of excluded fiduciary. An excluded fiduciary is not liable, either individually or as a fiduciary, for either of the following: (1) Any loss that results from compliance with the direction of a trust advisor, custodial account owner, or authorized designee of a custodial account owner; (2) Any loss that results from a failure to take any action proposed by an excluded fiduciary that requires a prior authorization of the trust advisor if that excluded fiduciary sought but failed to obtain that authorization. Any excluded fiduciary 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, custodial account owner, or authorized designee of a custodial account owner had authority to direct the acquisition, disposition or retention of any such investment.

Thus, in addition to permitting a particular fiduciary to be excluded from certain powers under the governing instrument, South Dakota has independently codified the concepts of an investment trust advisor and a distribution trust advisor who, presumably, simply by being named as such, would have the powers set forth in the statute. Each of an investment trust advisor and a distribution trust advisor has sole and absolute discretion with respect to his or her powers, and the exercise or nonexercise of the authority of the advisor binds all other persons. Each advisor is bound to act in the best interests of the trust and is therefore a fiduciary.

It would seem that the intention of the statute is that the designation of an investment trust advisor or distribution trust advisor would automatically make the trustee an excluded trustee with respect to the authority held by the advisor. Caution might dictate making that result clear in the governing instrument.

Wyoming

Wyoming is an example of another blended liability approach. The statute appears to be derived from UTC section 808, but the "unless" clause referring to directions manifestly contrary to the terms of the trust or which the trustee knows would constitute a serious breach of fiduciary duty was not incorporated. The statute requires a trustee to follow the direction of an advisor. But the statute is arguably silent as to whether the directed trustee is relieved of liability (to the same extent as in the Delaware statute, for example), for following such a direction. This raises the issue of whether the governing instrument could include such exonerating language.

Such exoneration is likely subject to the limitations on exculpation of a trustee under section 1011 of the UTC which Wyoming has adopted.[7] Accordingly, it may be that a directed trustee cannot be exonerated if the directed trustee acts in bad faith or with reckless indifference to the purposes of the trust or the interests of the beneficiaries.

[7] See Wyo. Stat. § 4-10-1012.

The Wyoming statute also changes paragraph (d) of UTC section 808 to provide that a person with a power to direct (other than a beneficiary) *is* a fiduciary, rather than *is presumptively* a fiduciary. Consistent with the UTC, the stated fiduciary obligation of the power holder is to act in good faith and with regard to the purposes of the trust. The provision from the UTC that any person with a power to direct is liable for losses that result from a breach of fiduciary duty is also retained. It appears, therefore, that in the case of a directed trust, the Wyoming statute endeavors to shift the fiduciary duties to the beneficiaries from the trustee to the power holder by eliminating the exception to the trustee's duty to follow the direction of the power holder and by designating the power holder as a fiduciary in all circumstances (except if the power holder is a beneficiary).

> Wyo. Stat. § 4-10-808. Powers to direct
>
> (a) While a trust is revocable, the trustee may follow a written direction of the settlor that is contrary to the terms of the trust.
>
> (b) If the terms of a trust confer upon a person other than the settlor of a revocable trust power to direct certain actions of the trustee, the trustee shall act in accordance with an exercise of the power.
>
> (c) The terms of a trust may confer upon a trustee or other person, as provided in article 7 of this act, a power to direct the modification or termination of the trust.
>
> (d) A person, other than a beneficiary, who holds a power to direct is 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 with respect to the holder's power.

Alaska

Still other states, such as Alaska, allow the settlor to give a third party the right to direct the trust, but do not relieve the trustee from any liability for actions or decisions taken upon the advice of an advisor unless the trust instrument exonerates such liability. However, unlike Delaware, in Alaska, unless the trust instrument states otherwise, a trustee is not required to follow the advice of the advisor. This puts a high premium on proper drafting, as the presumption is in favor of full fiduciary liability, notwithstanding an authorization in the governing instrument for a third party to advise the trustee. The directed trust statute in Alaska provides:

> Alaska Stat. § 13.36.375. Trustee advisor
>
> (a) A trust instrument may provide for the appointment of a person to act as an advisor to the trustee with regard to all or some of the matters relating to the property of the trust.
>
> (b) Unless the terms of the trust instrument provide otherwise, if an advisor is appointed under (a) of this section, the property and management of the trust and the exercise of all powers and discretionary acts exercisable by the trustee remain vested in the trustee as fully and effectively as if an advisor were not appointed, the trustee is not required to follow the advice of the advisor, and 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.

Interestingly, unless provided to the contrary in the governing instrument, under Alaska law, an advisor appears to have no fiduciary duties whatsoever to the trust beneficiaries. Thus, it seems a trust instrument could be drafted to require a trustee to follow the directions of an advisor and exonerate the trustee for following those directions, and, without more, it would seem neither the trustee nor the advisor has any fiduciary liability to the beneficiaries when the trustee follows the directions of the advisor. Presumably, both would be held to a standard of good faith.

Suggested guidelines for a directed trust statute

Based on the foregoing analysis, we would suggest the following guidelines in drafting a directed trust statute to achieve the settlor's objectives of having a directed trust while at the same time protecting the interests of the directed trustee and the beneficiaries:

1. *Limit liability of directed trustee and advisor.* If the settlor wishes to have a true directed trust in which the trustee will follow the direction of an advisor, who may or may not be a co-trustee, without the trustee being required independently to evaluate the prudence of those directions, then the Delaware approach under which the trustee is liable for losses only in the event of "wilful misconduct" would appear optimal. By a "true directed trust," we mean a trust over which the advisor has authority to direct or prevent actions of the trustee. This should be distinguished from a trust that requires a trustee to obtain the consent of an advisor, which is more in the nature of a co-trustee relationship, and would be subject to different obligations and liabilities on the part of the trustee.

In the case of a true directed trust that exonerates the directed trustee, the advisor should be held to a fiduciary standard of good faith that may not be waived in the governing instrument. Otherwise, it seems to us that the trust might fail, as no one would be acting in a fiduciary capacity with respect to the decisions in the hands of the advisor. Section 105 of the UTC provides that the trustee's duty to act in good

faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries may not be waived. This principle seems to us fundamental to the existence of a trust. Therefore, if the advisor effectively takes on certain aspects of the trust administration by directing or preventing certain actions of the trustee, the advisor should become a fiduciary to that extent and be subject to a minimum fiduciary standard of good faith.

2. *Scope of authority of the advisor.* We believe the South Dakota approach of defining certain types of trust advisors is very helpful because it permits a settlor to incorporate those definitions by reference, thus adding certainty to the scope of the advisor's authority. Any definition should make clear that the advisor may be designated for all or any part of the statutorily defined scope of duties. Thus, for example, an investment trust advisor should be permitted to act with respect to the entire trust estate, or with respect to only one asset or category of assets, such as interests in entities that are not publicly traded. Similarly, a distribution trust advisor should be permitted to act exclusively with respect to distributions to a particular beneficiary or with respect to a particular trust asset, such as an interest in a closely held business.

If the advisor is also a co-trustee, we believe the Florida approach of expressly excluding all other trustees from authority over and liability for following the directions (except in the case of willful misconduct) of the advisor is optimal. We believe this will encourage settlors to name multiple trustees, each particularly suited to one or more tasks of trusteeship, and allow each to be exclusively responsible as a trustee in his, her or its area of expertise. Accordingly, in the case of a trustee/advisor, all other trustees would be defined as excluded trustees and substantially exonerated from liability. If, on the other hand, the advisor is not a co-trustee, then we suggest that the approach in paragraph 1 above be followed.

3. We believe any directed trustee statute should clarify the ambiguity in the UTC with respect to an advisor who is also a beneficiary. If a beneficiary is the advisor, the beneficiary should not be subject to a fiduciary standard only if the beneficiary is the only person whose interest in the trust (as defined under state law taking account of virtual representation) is affected by directions given by the advisor. So, in Florida, for example, where a beneficiary with a special power of appointment may represent the interests of the takers in default, if the beneficiary were the investment advisor of a trust for the exclusive lifetime benefit of that beneficiary over which the beneficiary has a testamentary special power of appointment, then the beneficiary, as investment advisor, would not have a fiduciary duty to anyone else. But if the beneficiary is only an income beneficiary or is only one of multiple permissible income and principal beneficiaries, then the beneficiary, acting as advisor, should be held to a minimum fiduciary standard of good faith.

Conclusion

Allowing settlors to require that third parties will control or direct certain functions of the trustee allows a great deal of flexibility in family succession planning by permitting the settlor to designate multiple persons with different skills to handle the duties of trust administration, without requiring the trustee to be involved in all decisions. The law has developed to permit such direction without subjecting the third party to the usual liability of a trustee while at the same time largely exonerating the trustee from liability for following the directions. As the law continues to evolve, the scope of liability of trustees who are directed by others as well as that of the advisor will continue to be defined.

The statutory framework of a particular state may prove to be a jurisdictional pull for settlors who wish to divide fiduciary duties into various components, such as investments, distributions and administration, and have different persons responsible for those components. The approach is a logical extension of the growth in assets held in trust, which enhances the likelihood that one size will not fit all responsibilities of trusteeship. ■