

The More Trustees the Merrier? All About Directed Trusts

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THE MORE TRUSTEES THE MERRIER? ALL ABOUT DIRECTED TRUSTS

I. Introduction

- A. Directed trusts are not new and, in fact, have become common place over the last decade.
- B. In the early days of directed trusts, the purpose was to limit a trustee's power to sell specific trust assets without the consent or written direction of a person not serving as trustee. Today the limitations on a trustee's authority to deal with certain trust assets often affect all of the trustee's discretionary powers over the assets including voting decisions, management decisions, distribution decisions and other decisions previously solely within the realm of the trustee's discretion.
- C. Directed trusts are popular because of the desire to structure specialized and complex objectives that may require a lack of diversification or investment in non-traditional or risky assets, including closely held businesses, limited liability company interests and oil and gas interests.¹
- D. These special and complex objectives require specialized knowledge and often conflict with the traditional fiduciary duties imposed on trustees. Many trustees are unwilling to subject themselves to the risk of potentially breaching these traditional limitations.²
- E. One way to accomplish these objectives is through the use of a directed trust. In fact, trustees faced with the fiduciary duty to diversify trust assets and deal impartially with income beneficiaries and remainder beneficiaries welcome the ability to limit their liability through the use of directed trusts.³
- F. The increased use of directed trusts has led to the enactment of directed trust statutes in some states while others rely on the UTC or Third Restatement of Trusts for implementation and administration of directed trusts.
- G. There is no consistent vocabulary in practice to describe the person other than a trustee who holds a power in a directed trust. Common terms used include "trust protector", "trust adviser" and "trust director."
- H. There is uncertainty in existing law about the fiduciary status of a nontrustee that has a power over a trust and about the fiduciary duty of a trustee with respect to actions taken or directed to be taken by the nontrustee.

¹ See Todd A. Flubacher, *Directed Trusts: Panacea or Plague?*, NAEPC Journal of Estate Tax Planning, September 2015.

² See *id.*

³ See Michael M. Gordon, *Directed Trusts, Trust Protectors, Private Trust Companies and Other Bells and Whistles*, 10th Annual International Estate Planning Institute, March 13, 2014.

II. Current New York Law

- A. New York does not have a directed trust statute. Any attempt to create a directed trust in New York would be met with unpredictable results as evidenced by the case law.⁴
- B. In a recent case, the court held that a directed trust was effective, but a later case held that it was not.
- C. In *In re Estate of Rubin*, the decedent's Will named his son and daughter as co-executors but specified that, in the event of disagreement, they were to act as directed by two named individuals.
 - 1. At the son's request, the two named individuals directed that he be given sole check-writing authority and management responsibility over five commercial properties.⁵
 - 2. Rejecting the daughter's claim that the arrangement violated her rights as co-executor, the court held that "the designation of advisors...to make directives controlling the actions of the co-executors in any disputes is a valid limitation upon the powers of such executors."⁶
- D. In *In re Rivas*, the corporate trustee objected to a direction by the Investment Advisory Committee formed under the governing instrument of a charitable trust to invest in the charitable donee's long-term investment pool.
 - 1. The court held: [T]his Court cannot allow the proposed investment of the Helen Rivas Trust corpus, as such investment in the LTIP is contrary to the Agreement and the intent of the settlor, may give rise to an impermissible division of fiduciary loyalties among the majority of the Advisory Committee.⁷
 - 2. The court held that this would also violate the Prudent Investor Act.

III. Directed Trust Laws in Other Jurisdictions

- A. As discussed above, the primary issue raised by the use of a directed trust is the allocation of fiduciary duties to the various parties involved.
 - 1. The duties imposed on a fiduciary require the fiduciary to act in good faith, trust, confidence and candor with respect to the beneficiaries of a trust.⁸
 - 2. If the trust advisor/protector is not a fiduciary role, then what is it? If the beneficiaries become unhappy with the administration of a directed trust, who is

⁴ See *In re Estate of Rubin*, 143 Misc.2d 303, 540 N.Y.S.2d 944 (Sur. Ct., Nassau Co. 1989), *aff'd*, 172 A.D.2d 841, 570 N.Y.S.2d 996 (2d Dep't 1991); *In re Rivas*, 30 Misc.3d 1207(A), 958 N.Y.S.2d 648 (Sur. Ct., Monroe Co. 2011), *aff'd* 93 A.D.3d 1233, 939 N.Y.S.2d 918 (4th Dep't) 2012).

⁵ 143 Misc. 2d at 303.

⁶ *Id.* at 308.

⁷ *In re Rubin*, 30 Misc.3d at 18.

⁸ See Stephan R. Leimberg, Jonathan E. Gopman, Michael A. Sneeringer, *The Tools and Techniques of Trust Planning*, 1st Edition

responsible or liable? Does the directed trust structure provide enough recourse to the beneficiaries in the event of misconduct?

3. The clarification of the trust advisor/protector/trust director is critical for establishing the standard of care owed to the beneficiaries.⁹
- B. In evaluating the laws in other states, four groups have emerged in the treatment of directed trusts.
1. States that have adopted UTC. Section 808(b) of the Uniform Trust Code either in whole or in part¹⁰:
 - a. Section 808(b) provides:

If the terms of a trust confer upon a person other than the trustee of a revocable trust power to direct certain actions of the trustee, the trustee shall act in accordance with an exercise of the power *unless the attempted exercise is manifestly contrary to the terms of the trust or the trustee knows the attempted exercise would constitute a serious breach of a fiduciary duty* that the person holding the power owes to the beneficiaries of the trust. [emphasis added]
 - b. Under the UTC, the directed trustee must act as directed. The trustee may only refuse to act as directed if the directed trustee believes that the directed action would contravene the trust terms or would cause a serious breach of fiduciary duty.
 - c. The comments to Section 808 further provides

Powers to direct are most effective when the trustee is not deterred from exercising the power by fear of possible liability. On the other hand, the trustee does have overall responsibility for seeing that the terms of the trust are honored. For this reason, subsection (b) imposed only minimal oversight responsibility on the trustee. A trustee must generally act in accordance with the direction.¹¹
 - d. Under this approach, the directed trustee still has a fiduciary responsibility and potential liability for deciding whether to follow the direction.
 2. States that follow Section 185 of the Restatement (Second) of Trusts¹².
 - a. Section 185 of the Restatement (Second) of Trusts provides as follows¹³:

⁹ *See id.*

¹⁰ 20 states have adopted Section 808: Alabama, Arkansas, Florida, Kansas, Maine, Maryland, Massachusetts, Michigan, Mississippi, Montana, Nebraska, New Mexico, North Dakota, Oregon, Pennsylvania, South Carolina, Texas, Vermont, Virginia and West Virginia.

¹¹ Uniform Tr. Code, § 808 cmt.

¹² These states are Indiana and Iowa.

¹³ Restatement (Second) of Trusts § 185 (1989); *see also* Restatement (Third) of Trusts §75 which provides:

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.

- b. Under the Restatement, the trustee shall follow direction unless the 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*”. [emphasis added]
 - c. Thus, the trustee continues to possess the fiduciary responsibility and liability for deciding whether to follow the direction.
3. States that have enacted directed trust statutes (or modified the UTC or Restatement) to provide stronger protection to the directed trustee.¹⁴
- a. A subset of these states provide that a directed trustee has no duty or liability for complying with an exercise of a power of direction. These states include Alaska, New Hampshire, Nevada, and South Dakota.
 - 1) The policy rationale for these “no duty” statutes is that duty should follow power. If a director has the exclusive authority to exercise a power of direction, then the director should be the exclusive bearer of fiduciary duty.
 - 2) By placing the exclusive duty on a director, the duty owed to the beneficiary is not diminished.
 - 3) A beneficiary’s only recourse for misconduct by the trust director is an against the director for breach of the director’s fiduciary duty to the beneficiary.
 - b. Other states that include Delaware, Illinois, Texas and Virginia, provide that a directed trustee is not liable for complying with a direction of a trust director unless by doing so the directed trustee would personally engage in willful misconduct.
 - 1) Under this approach, the theory is that because the trustee is at the center of the trust, the trustee must bear at least some duty even if the trustee is acting under the direction of a director.

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.

¹⁴ Alaska, Arizona, Delaware, Florida, Georgia, Idaho, Illinois, Indiana, Kentucky, Missouri, Nevada, New Hampshire, North Carolina, Ohio, Oklahoma, South Dakota, Tennessee, Utah, Virginia, Washington, Wisconsin, Wyoming.

- 2) Under traditional notions of trust law, the trustee must be accountable to the beneficiary in some way.
 - 3) A beneficiary's main recourse for misconduct by the trust director is an action against the director for breach of the fiduciary duty to the beneficiary.
 - 4) Under this approach, the beneficiary also has recourse against the trustee, but only if the trustee's compliance with the direction amounted to willful misconduct by the trustee.
 - 5) This has the effect of increasing the total fiduciary duties owed to a beneficiary.
4. States that have no statutory framework for third-party advisors.¹⁵
- C. Delaware directed trust law was enacted in 1986.¹⁶
1. Delaware law recognizes a broad class of advisers including direction advisers, consent advisers and trust protectors. Where one or more persons are given authority by the terms of a governing instrument to direct, consent to or disapprove a fiduciary's actual or proposed investment decisions, distribution decisions or other decisions of the fiduciary, such persons shall be considered to be advisers and fiduciaries when exercising such authority unless the governing instrument otherwise provides.¹⁷
 2. When a trustee acts in accordance with the directions of a trust direction adviser, the trustee will only be liable for its "willful misconduct".
 3. If a governing instrument provides that a fiduciary is to follow the direction of an adviser, and the fiduciary acts in accordance with such a direction, then except in cases of willful misconduct on the part of the fiduciary so directed, the fiduciary shall not be liable for any loss resulting directly or indirectly from any such act.¹⁸
 4. The term willful misconduct means intentional wrongdoing and not mere negligence, gross negligence or recklessness.¹⁹
 5. The term wrongdoing means malicious conduct or conduct designed to defraud or seek an unconscionable advantage.²⁰
 6. If a governing instrument provides that a fiduciary is to make decisions with the consent of an adviser, then except in cases of willful misconduct or gross negligence on the part of the fiduciary, the fiduciary shall not be liable for any loss resulting directly or indirectly from any act taken or omitted as a result of

¹⁵ California, Connecticut, Hawaii, Louisiana, Minnesota, New Jersey, New York and Rhode Island.

¹⁶ Del. Code Ann. Title 12 §3313.

¹⁷ 12 Del. C. § 3313(a)

¹⁸ 12 Del. C. § 3313(b).

¹⁹ 12 Del. C. § 3301(g) and 12 Del. C. § 3301(h)(4).

²⁰ 12 Del. C. § 3301(g).

such adviser's failure to provide such consent after having been requested to do so by the fiduciary.²¹

7. ... the term "advisor" shall include a "protector" who shall have all of the power and authority granted to the protector by the terms of the governing instrument, which may include but shall not be limited to:
 - (i) The power to remove and appoint trustees, advisers, trust committee members, and other protectors;
 - (ii) The power to modify or amend the governing instrument to achieve favorable tax status or to facilitate the efficient administration of the trust; and
 - (iii) The power to modify, expand, or restrict the terms of a power of appointment granted to a beneficiary by the governing instrument.²²
8. Whenever a governing instrument provides that a fiduciary is to follow the direction of an adviser with respect to investment decisions, distribution decisions, or other decisions of the fiduciary, then, except to the extent that the governing instrument provides otherwise, the fiduciary shall have no duty to:
 - (i) monitor the conduct of the adviser;
 - (ii) provide advice to the adviser or consult with the adviser; or
 - (iii) communicate with or warn or apprise any beneficiary or third party concerning instances in which the fiduciary would or might have exercised the fiduciary's own discretion in a manner different from the manner directed by the adviser.²³
9. Absent clear and convincing evidence to the contrary, the actions of the fiduciary pertaining to matters within the scope of the adviser's authority (such as confirming that the adviser's directions have been carried out and recording and reporting actions taken at the adviser's direction), shall be presumed to be administrative actions taken by the fiduciary solely to allow the fiduciary to perform those duties assigned to the fiduciary under the governing instrument and such administrative actions shall not be deemed to constitute an undertaking by the fiduciary to monitor the adviser or otherwise participate in actions within the scope of the adviser's authority.²⁴
10. *Duemler v. Wilmington Trust Company*²⁵ - a Delaware Vice Chancellor ruled that a corporate trustee was not liable for the failure of a sophisticated (*i.e.*, securities lawyer) investment adviser to direct it on an investment decision where the trustee forwarded relevant information to the adviser.

²¹ 12 Del. C. § 3313(c).

²² 12 Del. C. § 3313(f).

²³ 12 Del. C. § 3313(e).

²⁴ *Id.*

²⁵ 2004 Del. Ch. LEXIS 206 (Del. Ch. 2004).

- a. The Vice Chancellor held: The Court...finds that section 3313(b) of title 12 of the Delaware Code insulates fiduciaries of a Delaware trust from liability associated with any loss to the trust where a governing instrument provides that the fiduciary is to follow the direction of an advisor, the fiduciary acts in accordance with such direction and the fiduciary did not engage in willful misconduct.
 - b. The trust agreement involved in this case appointed Plaintiff as the investment advisor to the Trust and, at all times, Plaintiff made all of the investment decisions for the Trust, including not to tender the securities in the Exchange Offer.
 - c. In connection with Plaintiff's decision not to tender the securities in the Exchange Offer, Wilmington Trust acted in accordance with Plaintiff's instructions, did not engage in willful misconduct by not forwarding the Exchange Offer materials to Plaintiff and had no duty to provide information or ascertain whether Plaintiff was fully informed of all relevant information concerning the Exchange Offer.
 - d. Accordingly, 12 Del. C. § 3313(b) insulates Wilmington Trust from all liability for any loss to the Trust resulting from plaintiff's decision not to tender the securities in the Exchange Offer.
11. Delaware adopted 12 Del. C. § 3317 in 2010.
- a. The statute states that, except as provided in the governing instrument, each trust fiduciary (including trustees, advisers, protectors, and other fiduciaries) has a duty to keep the other fiduciaries reasonably informed about the administration of the trust with respect to the specific duty or function being performed by that fiduciary.
 - b. The statute further provides that a fiduciary who requests and receives such information has no duty to monitor the conduct of the other fiduciary, provide advice or consult with the other fiduciary or provide information or communicate or warn any beneficiary or third party concerning instances in which the fiduciary receiving the information would or might have exercised the fiduciary's own discretion in a different manner.
12. Under the Delaware statute, there is potential liability of the adviser appointed to direct the trustee with respect to investment decisions, distribution decisions or other decisions of the trustee.
- a. Absent express language in the governing instrument such adviser is deemed to serve in a fiduciary capacity and will be held to the prudent person standard.

- b. Delaware law permits a trust agreement to exculpate and indemnify a fiduciary (including an adviser) for all acts other than those committed with willful misconduct.²⁶
- D. Uniform Directed Trust Act (**See Exhibit A**)
1. The Act introduces several terms.
 - a. A power is called a “power of direction.”²⁷ The definition is very broad and includes any power over a trust to the extent the power is exercisable at a time when the power holder is not serving as a trustee. UDTA Section 5 carves out powers that are not intended to be a “power of direction” under the Act.
 - b. The person that holds the power is called a “trust director.”²⁸
 - c. A trustee that is subject to the power is called a “directed trustee.”²⁹ It refers only to a trustee that is subject to direction by a trust director. This does not include a trustee that is subject to a direction by a co-trustee.
 - d. And the trust is called a “directed trust.”³⁰
 2. The Act applies to any arrangement that exhibits the functional features of a directed trust even if the terms of the trust use other terminology such as “trust protector, “trust advisor,” or “administrative trustee.”
 3. The Act applies prospectively. All trusts that are administered in an enacting state are governed by the act but only with respect to a decision or action occurring on or after the effective date or, if the trust’s principal place of administration was changed, then only with respect to a decision or action occurring after the change.
 4. Section 5 describes five categories of powers that are not covered by the Act³¹.
 - a. Power of Appointment
 - b. Power to appoint or remove a trustee or trust director
 - c. Power of grantor to revoke the trust
 - d. Power of beneficiary the exercise or nonexercised of which affects the beneficial interest of the beneficiary or another beneficiary represented by the beneficiary.
 - e. Any power for which the terms of the trust state that it is held in a nonfiduciary capacity solely to achieve the grantor’s tax objectives.
 5. Powers of the Trust Director³²

²⁶ 12 Del. C. § 3303(a).

²⁷ Uniform Directed Trust Act § 2(5).

²⁸ UDTA § 2(9).

²⁹ UDTA § 2(3)

³⁰ UDTA § 2(2).

³¹ UDTA § 5 *et. seq.*

- a. The UDTA does not enumerate specific powers or define the scope of a trust director's powers. Instead, the powers must be specified by the terms of the trust.
 - b. The ULC drafting committee contemplated that this section would validate terms of a trust that grant a power to a trust director to direct investments; modify, reform, terminate or decant a trust; change the principal place of administration; determine the capacity of a trustee, grantor, director or beneficiary; determine trustee's compensation; release a trustee from liability, etc.³³
 - c. Further "appropriate powers"³⁴
 - (1) Prescribes a default rule under which a trust director may exercise further powers as appropriate to the director's exercise of the director's express powers.
 - (2) Appropriateness is judged in relation to the purpose for which the power was granted and the function being carried out by the director.
 - (3) Would include further powers such as: incurring reasonable costs; making a report or accounting to a beneficiary; prosecuting, defending or joining an action, claim or judicial proceeding relating to the trust; employing a profession for advice or assistance.³⁵
 - d. Majority decision of trust directors. The Act provides a default rule of majority action for multiple trust directors with joint powers.³⁶
- 6. The Act imposed all the same rules that would apply to a trustee in a like position such as where a state would require a trustee to give notice to a state Attorney General before taking certain actions with respect to a charitable trust or with respect to payback provisions meant to comply with Medicaid law.³⁷
 - 7. The trust director has the same duties and liabilities as a trustee in a like position would be subject to, including to act prudently, in the sole interest of the beneficiaries and with impartiality.³⁸
 - a. The trust director functions much like a trustee in a non-directed trust so the trust director should have the same duties as a trustee.
 - b. The Act absorbs existing state trust fiduciary laws which avoids the need to replicate already existing laws and accommodates the diversity across

³² UDTA §6.

³³ See UDTA § 6 cmt. pg. 14.

³⁴ UDTA § 6(b)(1).

³⁵ See UDTA § 6 cmt. pg. 15.

³⁶ UDTA § 6(b)(2).

³⁷ UDTA § 7.

³⁸ UDTA § 8 (a).

the states in the particulars of a trustee's default and mandatory fiduciary duties.

- c. Trust director is subject to the same rules as a trustee with regard to an exoneration clause.
 - d. Section (b) contemplates the situation in which a health care professional is acting as a trust director and the terms of the trust require a health care professional to determine the capacity of a beneficiary or the grantor. In making this determination, the health care professional would not be subject to a fiduciary duty or liability under the Act.³⁹
8. A directed trustee is required to take reasonable action to comply with a trust director's power of direction and the directed trustee is not liable for acting.⁴⁰
- a. The duty to take reasonable action depends on the context of the power of direction. The duty is to take reasonable action to comply with whatever the terms of the trust require of a trustee in connection with a trust director's exercise of a power of direction.
 - b. The trustee should not comply with a direction that is outside the scope of the director's power of direction. To do so would be a breach of fiduciary duty.
 - c. A trustee is not under a duty to ensure that the substance of the direction is reasonable. A trustee that takes reasonable action to comply with a direction is not liable even if the substance is unreasonable.
 - d. A trustee is only liable for its own breach of trust in executing a direction if to do so would constitute willful misconduct.⁴¹
 - e. The terms of a trust may not reduce the trustee's duty below the standard of willful misconduct. Such a provision would be unenforceable.
9. Trustee and trust director has duty to provide information to each other that is sufficient to fulfill their obligations. Information must be disclosed only if it is reasonable related both to the powers and duties of person making the disclosure and to the person receiving the disclosure.⁴²
10. Trustee has no duty to monitor a trust director or inform or give advice to a grantor, beneficiary, trustee or trust director concerning instances in which the trustee might have acted differently than the director.⁴³
11. Co-Trusteeship. Section 12 of UDTA allows a grantor to choose the traditional rules of co-trusteeship or the more permissive rules of a directed trusteeship. A

³⁹ UDTA § 8(b).

⁴⁰ UDTA § 9(a).

⁴¹ UDTA § 9(b).

⁴² UDTA § 10; *see also* cmt. pg. 27.

⁴³ UDTA § 11(a). Under the UDTA the outcome of *Rollins v. Branch Banking & Trust Company of Virginia* would have been different.

co-trustee may only have the duty requires by the reasonable action and willful misconduct standards if the grantor chooses and the terms of the trust dictate. The default rule is the rules of co-trusteeship.

12. The Act absorbs state law governing the statute of limitations for bringing an action against a trustee as well as defenses that are available to trustee.⁴⁴

E. Proposed New York Uniform Directed Trust Act

1. The New York Uniform Directed Trust Act proposal is modeled after UDTA and contemplates the enactment of the proposed New York Trust Code (modeled after the UTC).
2. The NYUDTA uses the reasonable action and willful misconduct standard for directed trustees.
3. The definition of willful misconduct is added (modeled after the Delaware statute)
 - a. “Willful misconduct” means intentional wrongdoing, not mere negligence, gross negligence or recklessness.
 - b. “Wrongdoing” means malicious conduct or conduct designed to defraud or seek an unconscionable advantage.
4. Applies to trusts which have their principal place of administration in New York, subject to certain limitations. NYUDTA clarifies that the terms of a directed trust which designate its principal place of administration will be valid and controlling if such designation satisfies the requirements of the proposed New York Trust Code.
5. NYUDTA contains the same exclusions as Section 5 of the UDTA discussed above.
6. Major Differences from UDTA
 - a. Powers of the Trust Director. The UDTA leaves the power of the trust director undefined and leaves it to the terms of the trust to enumerate those powers. NYUDTA includes a set of illustrative powers in the statute. A similar set of powers are discussed in the comments to the UDTA.
 - b. NYUDTA provides a default definition of the power to direct investments.
 - c. NYUDTA provides a set of illustrative further powers appropriate to the exercise or nonexercise of a power of direction.
 - d. Application to co-Trustee. While the UDTA allows a grantor to choose whether to apply the rules of co-trusteeship or allow the rules of a directed trusteeship to apply, the NYUDTA instead follows the Delaware statute § 3313A which was just enacted in August 2017.

⁴⁴ See UDTA § 13 and § 14.

- e. NYUDTA provides that a co-trustee who is to be directed by a co-trustee is relieved from liability to the same extent as a directed trustee. It also allows a co-trustee to have exclusive authority over one or more trust powers, with concomitant duties and liabilities and relieves any other excluded co-trustee from having any duties or liabilities.

IV. Reforming an Existing New York Trust to a Directed Trust

A. Changing the Situs of a New York Trust

1. The willingness of the New York courts to change the situs of a testamentary trust away from New York to the jurisdiction where the trustees are resident has not been evident.
 - a. *Matter of Bush*, 2 Misc.3d 744, 774, N.Y.S.2d 298 (Sur. Ct. New York Co., 2003).
 - 1) Trustees of a testamentary trust sought to avoid New York State fiduciary income tax by requesting a resignation of the New York trustee and appointment of a Delaware trustee and requesting a transfer of two trusts to Delaware.
 - 2) The court stated that modifications to a testamentary trust will be granted so long as they are the least disruptive to the grantor's or testator's scheme.
 - 3) The change in trusteeship from a New York trustee to a Delaware trustee achieves the purpose of avoiding New York State income tax on the trust.
 - 4) The testator made an explicit direction that the trust be administered in accordance with New York law which demonstrates an intent for the New York courts to supervise the trust's administration. The court, therefore, denied the application to change the situs of the trust.⁴⁵
 - b. *Matter of Rockefeller*, 2 Misc.3d 554, 773 N.Y.S.2d 529 (Sur. Ct. New York Co., 2003).
 - 1) Petitioners who were trustees of a New York testamentary trust requested to allow the corporate trustee to resign in favor of an affiliate in Delaware and to change the situs of the trust to Delaware.
 - 2) The purpose of the requested changes was to eliminate the New York State fiduciary income tax payable by the trust.
 - 3) The court allowed the resignation of the New York trustee and appointment of the Delaware trustee but did not allow the change of situs to Delaware.

⁴⁵ *Matter of Bush*, 774 N.Y.S.2d at 299.

- 4) The court stated that the income tax purpose was satisfied by the change in trustee and the continued supervision of the trust by New York courts and the application of New York law was not inconsistent with that purpose.⁴⁶
 - 5) Decedent's will was silent concerning the permissibility of a change of situs of the trust. Therefore, where the "desired tax savings can be achieved by a change of trustee, a change of situs will not be allowed unless it would result in some benefit to the trust apart from the tax considerations themselves."⁴⁷
2. The New York Courts have allowed the change in situs in certain situations.
 - a. The court will permit transfer of the situs of the trust if the transfer is not prohibited by the instrument and would facilitate the administration of the trust.⁴⁸
 - b. The courts will allow a transfer of situs where the language of the will or trust agreement does not prohibit the transfer, either explicitly or implicitly, and the transfer will simplify the administration of the trust or promote the beneficiary's interest.⁴⁹
 3. Presumably if the governing instrument gives the fiduciary the authority to change the situs of the trust, then the courts will allow it.
- B. Decanting as a Tool to Reform an Existing New York Trust
1. It is possible for the trustee of a New York testamentary trust to decant to a trust with a situs in another state so that the law of that state governs the trust.
 - a. Decanting does not require court approval and there is nothing in EPTL 10-6.6 that prevents decanting to a trust with a situs in another state and trustees who are resident in that state.
 - b. The new appointed trust is created from the corpus of the invaded trust but is a new trust. In all likelihood, because the appointed trust is created by the trustee of the invaded trust, a testamentary trust becomes a lifetime trust.
 2. There may be an argument that a trustee who decants to a trust with a situs in a state other than New York can have letters revoked under SCPA 711(7) because

⁴⁶ *Matter of Rockefeller*, 773 N.Y.S.2d at 530.

⁴⁷ *Id* at 531; *see also Matter of Flexner*, 166 N.Y.S.2d 469 (1957) (where the transfer of situs was denied where the trust instrument specifically provided that it be governed under New York law, even though the grantor herself requested the transfer.).

⁴⁸ *See Matter of Garver*, NYLJ, Jan. 18, 2003, at 20, col. 3).

⁴⁹ *Matter of LeoGrande*, 2009 N.Y. Slip Op 33140(U); *see also Matter of Weinberger*, 250 N.Y.S.2d 887 (1st Dept. 1964) (where the court found that a transfer of situs would facilitate the administration of the trust because the distance between the two trustees had made the administration difficult); *Matter of McComas*, 630 N.Y.S.2d 895 (Sur. Ct. New York Co, 1995) (where the court granted the application for change in situs finding that the interests of the beneficiaries would be promoted by a transfer to the beneficiaries' residence).

the trustee has moved property out of the state of New York without court approval.

3. However, a trustee may distribute assets from a New York trust to a beneficiary outside of New York without issues. Thus, because the trustee is using its principal invasion power to appoint the assets of the invaded trust to the appointed trust, this is a weak argument, at best.

EXHIBIT A

UNIFORM DIRECTED TRUST ACT

SECTION 1. SHORT TITLE. This [act] may be cited as the Uniform Directed Trust Act.

SECTION 2. DEFINITIONS. In this [act]:

(1) “Breach of trust” includes a violation by a trust director or trustee of a duty imposed on that director or trustee by the terms of the trust, this [act], or law of this state other than this [act] pertaining to trusts.

(2) “Directed trust” means a trust for which the terms of the trust grant a power of direction.

(3) “Directed trustee” means a trustee that is subject to a trust director’s power of direction.

(4) “Person” means an individual, estate, business or nonprofit entity, public corporation, government or governmental subdivision, agency, or instrumentality, or other legal entity.

(5) “Power of direction” means a power over a trust granted to a person by the terms of the trust to the extent the power is exercisable while the person is not serving as a trustee. The term includes a power over the investment, management, or distribution of trust property or other matters of trust administration. The term excludes the powers described in Section 5(b).

(6) “Settlor” means a person, including a testator, that creates, or contributes property to, a trust. If more than one person creates or contributes property to a trust, each person is a settlor of the portion of the trust property attributable to that person’s contribution except to the extent another person has the power to revoke or withdraw that portion.

(7) “State” means a state of the United States, the District of Columbia, Puerto Rico, the United States Virgin Islands, or any other territory or possession subject to the jurisdiction of the United States.

(8) “Terms of a trust” means:

(A) except as otherwise provided in subparagraph (B), the manifestation of the settlor's intent regarding a trust's provisions as:

(i) expressed in the trust instrument; or

(ii) established by other evidence that would be admissible in a judicial proceeding; or

(B) the trust's provisions as established, determined, or amended by:

(i) a trustee or trust director in accordance with applicable law; [or]

(ii) court order[; or

(iii) a nonjudicial settlement agreement under [Uniform Trust Code Section 111]].

(9) "Trust director" means a person that is granted a power of direction by the terms of a trust to the extent the power is exercisable while the person is not serving as a trustee. The person is a trust director whether or not the terms of the trust refer to the person as a trust director and whether or not the person is a beneficiary or settlor of the trust.

(10) "Trustee" includes an original, additional, and successor trustee, and a cotrustee.

Legislative Note: A state that has enacted Uniform Trust Code (Last Revised or Amended in 2010) Section 103(18), defining "terms of a trust," or Uniform Trust Decanting Act (2015) Section 2(28), defining "terms of the trust," should update those definitions to conform to paragraph (8). A state that has enacted Uniform Trust Code Section 103(15) and (20) could replace paragraphs (6) and (10) of this section with cross-references to those provisions. A state that has not enacted Uniform Trust Code Section 111 should replace the bracketed language of paragraph (8)(B)(iii) with a cross reference to the state's statute governing nonjudicial settlement or should omit paragraph (8)(B)(iii) if the state does not have such a statute.

SECTION 3. APPLICATION; PRINCIPAL PLACE OF ADMINISTRATION.

(a) This [act] applies to a trust, whenever created, that has its principal place of administration in this state, subject to the following rules:

(1) If the trust was created before [the effective date of this [act]], this [act] applies only to a decision or action occurring on or after [the effective date of this [act]].

(2) If the principal place of administration of the trust is changed to this state on or after [the effective date of this [act]], this [act] applies only to a decision or action occurring on or after the date of the change.

(b) Without precluding other means to establish a sufficient connection with the designated jurisdiction in a directed trust, terms of the trust which designate the principal place of administration of the trust are valid and controlling if:

(1) a trustee's principal place of business is located in or a trustee is a resident of the designated jurisdiction;

(2) a trust director's principal place of business is located in or a trust director is a resident of the designated jurisdiction; or

(3) all or part of the administration occurs in the designated jurisdiction.

Legislative Note: A state that has enacted Uniform Trust Code (Last Revised or Amended in 2010) Section 108(a) could omit subsection (b) and instead add subsection (b)(2) to Section 108 if the state also adds to the state's Uniform Trust Code the definitions of power of direction and trust director from Section 2(5) and (9).

SECTION 4. COMMON LAW AND PRINCIPLES OF EQUITY. The common law and principles of equity supplement this [act], except to the extent modified by this [act] or law of this state other than this [act].

SECTION 5. EXCLUSIONS.

(a) In this section, "power of appointment" means a power that enables a person acting in a nonfiduciary capacity to designate a recipient of an ownership interest in or another power of appointment over trust property.

(b) This [act] does not apply to a:

(1) power of appointment;

(2) power to appoint or remove a trustee or trust director;

(3) power of a settlor over a trust to the extent the settlor has a power to revoke the trust;

(4) power of a beneficiary over a trust to the extent the exercise or nonexercise of the power affects the beneficial interest of:

(A) the beneficiary; or

(B) another beneficiary represented by the beneficiary[under Uniform Trust Code Sections 301 through 305] with respect to the exercise or nonexercise of the power; or

(5) power over a trust if:

(A) the terms of the trust provide that the power is held in a nonfiduciary capacity; and

(B) the power must be held in a nonfiduciary capacity to achieve the settlor's tax objectives under the United States Internal Revenue Code of 1986[, as amended][, and regulations issued thereunder][, as amended].

(c) Unless the terms of a trust provide otherwise, a power granted to a person to designate a recipient of an ownership interest in or power of appointment over trust property which is exercisable while the person is not serving as a trustee is a power of appointment and not a power of direction.

***Legislative Note:** A state that has not enacted Uniform Trust Code (Last Revised or Amended in 2010) Sections 301 through 305 should replace the bracketed language in subsection (b)(4)(B) with a cross reference to the state's statute governing virtual representation or should omit the bracketed language if the state does not have such a statute.*

A state that does not permit the phrase "as amended" when incorporating federal statutes or permit reference to "regulations issued thereunder" should delete the bracketed language in subsection (b)(5)(B).

SECTION 6. POWERS OF TRUST DIRECTOR.

(a) Subject to Section 7, the terms of a trust may grant a power of direction to a trust director.

(b) Unless the terms of a trust provide otherwise:

(1) a trust director may exercise any further power appropriate to the exercise or nonexercise of a power of direction granted to the director under subsection (a); and

(2) trust directors with joint powers must act by majority decision.

SECTION 7. LIMITATIONS ON TRUST DIRECTOR. A trust director is subject to the same rules as a trustee in a like position and under similar circumstances in the exercise or nonexercise of a power of direction or further power under Section 6(b)(1) regarding:

(1) a payback provision in the terms of a trust necessary to comply with the reimbursement requirements of Medicaid law in Section 1917 of the Social Security Act, 42 U.S.C. Section 1396p(d)(4)(A)[, as amended][, and regulations issued thereunder][, as amended]; and

(2) a charitable interest in the trust, including notice regarding the interest to [the Attorney General].

Legislative Note: A state that does not permit the phrase “as amended” when incorporating federal statutes or that does not permit reference to “regulations issued thereunder” should delete the bracketed language in paragraph (1) accordingly.

In paragraph (2), “Attorney General” is in brackets to accommodate a state that grants enforcement authority over a charitable interest in a trust to another public official.

SECTION 8. DUTY AND LIABILITY OF TRUST DIRECTOR.

(a) Subject to subsection (b), with respect to a power of direction or further power under Section 6(b)(1):

(1) a trust director has the same fiduciary duty and liability in the exercise or nonexercise of the power:

(A) if the power is held individually, as a sole trustee in a like position and under similar circumstances; or

(B) if the power is held jointly with a trustee or another trust director, as a cotrustee in a like position and under similar circumstances; and

(2) the terms of the trust may vary the director's duty or liability to the same extent the terms of the trust could vary the duty or liability of a trustee in a like position and under similar circumstances.

(b) Unless the terms of a trust provide otherwise, if a trust director is licensed, certified, or otherwise authorized or permitted by law other than this [act] to provide health care in the ordinary course of the director's business or practice of a profession, to the extent the director acts in that capacity, the director has no duty or liability under this [act].

(c) The terms of a trust may impose a duty or liability on a trust director in addition to the duties and liabilities under this section.

SECTION 9. DUTY AND LIABILITY OF DIRECTED TRUSTEE.

(a) Subject to subsection (b), a directed trustee shall take reasonable action to comply with a trust director's exercise or nonexercise of a power of direction or further power under Section 6(b)(1), and the trustee is not liable for the action.

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

(c) An exercise of a power of direction under which a trust director may release a trustee or another trust director from liability for breach of trust is not effective if:

(1) the breach involved the trustee's or other director's willful misconduct;

(2) the release was induced by improper conduct of the trustee or other director in procuring the release; or

(3) at the time of the release, the director did not know the material facts relating to the breach.

(d) A directed trustee that has reasonable doubt about its duty under this section may petition the [court] for instructions.

(e) The terms of a trust may impose a duty or liability on a directed trustee in addition to the duties and liabilities under this section.

Legislative Note: A state that has enacted the Uniform Trust Code (Last Revised or Amended in 2010) should move Section 808(a) into Section 603, delete Section 808(b) through (d), and add “subject to [insert cite to Uniform Directed Trust Act Sections 9, 11, and 12],” to the beginning of subsection (b)(2) of Section 105. Section 105(b)(2) prescribes the mandatory minimum fiduciary duty of a trustee, which is superseded with respect to a directed trustee by the willful misconduct mandatory minimum of this section.

The term “court” in subsection (d) of this section should be revised as needed to refer to the appropriate court having jurisdiction over trust matters.

SECTION 10. DUTY TO PROVIDE INFORMATION TO TRUST DIRECTOR OR TRUSTEE.

(a) Subject to Section 11, a trustee shall provide information to a trust director to the extent the information is reasonably related both to:

(1) the powers or duties of the trustee; and

(2) the powers or duties of the director.

(b) Subject to Section 11, a trust director shall provide information to a trustee or another trust director to the extent the information is reasonably related both to:

(1) the powers or duties of the director; and

(2) the powers or duties of the trustee or other director.

(c) A trustee that acts in reliance on information provided by a trust director is not liable for a breach of trust to the extent the breach resulted from the reliance, unless by so acting the trustee engages in willful misconduct.

(d) A trust director that acts in reliance on information provided by a trustee or another trust director is not liable for a breach of trust to the extent the breach resulted from the reliance, unless by so acting the trust director engages in willful misconduct.

SECTION 11. NO DUTY TO MONITOR, INFORM, OR ADVISE.

(a) Unless the terms of a trust provide otherwise:

(1) a trustee does not have a duty to:

(A) monitor a trust director; or

(B) inform or give advice to a settlor, beneficiary, trustee, or trust director

concerning an instance in which the trustee might have acted differently than the director; and

(2) by taking an action described in paragraph (1), a trustee does not assume the duty excluded by paragraph (1).

(b) Unless the terms of a trust provide otherwise:

(1) a trust director does not have a duty to:

(A) monitor a trustee or another trust director; or

(B) inform or give advice to a settlor, beneficiary, trustee, or another trust director

concerning an instance in which the director might have acted differently than a trustee or another trust director; and

(2) by taking an action described in paragraph (1), a trust director does not assume the duty excluded by paragraph (1).

SECTION 12. APPLICATION TO COTRUSTEE. The terms of a trust may relieve a cotrustee from duty and liability with respect to another cotrustee's exercise or nonexercise of a power of the other cotrustee to the same extent that in a directed trust a directed trustee is relieved from duty and liability with respect to a trust director's power of direction under Sections 9 through 11.

Legislative Note: A state that has enacted Uniform Trust Code (Last Revised or Amended in 2010) Section 703(c) or (g) should revise those sections to make them subject to this section. In the alternative, the state could insert this section as a new subsection in Section 703, and make subsections (c) and (g) subject to that new subsection if the state also adds to its Uniform Trust Code the definitions of "directed trustee," "power of direction," and "trust director" from Section 2(3), (5), and (9).

SECTION 13. LIMITATION OF ACTION AGAINST TRUST DIRECTOR.

(a) An action against a trust director for breach of trust must be commenced within the same limitation period as[under Uniform Trust Code Section 1005] for an action for breach of trust against a trustee in a like position and under similar circumstances.

(b) A report or accounting has the same effect on the limitation period for an action against a trust director for breach of trust that the report or accounting would have[under Uniform Trust Code Section 1005] in an action for breach of trust against a trustee in a like position and under similar circumstances.

Legislative Note: A state that has enacted Uniform Trust Code (Last Revised or Amended in 2010) Section 1005 should update the bracketed language to refer to that enactment. A state that has enacted a statute other than Uniform Trust Code Section 1005 to govern limitation of an action against a trustee should replace the bracketed language with a cross reference to that statute. A state that has not enacted a statutory limitation should delete the bracketed language.

SECTION 14. DEFENSES IN ACTION AGAINST TRUST DIRECTOR. In an action against a trust director for breach of trust, the director may assert the same defenses a trustee in a like position and under similar circumstances could assert in an action for breach of trust against the trustee.

SECTION 15. JURISDICTION OVER TRUST DIRECTOR.

(a) By accepting appointment as a trust director of a trust subject to this [act], the director submits to personal jurisdiction of the courts of this state regarding any matter related to a power or duty of the director.

(b) This section does not preclude other methods of obtaining jurisdiction over a trust director.

SECTION 16. OFFICE OF TRUST DIRECTOR. Unless the terms of a trust provide otherwise, the rules applicable to a trustee apply to a trust director regarding the following matters:

- (1) acceptance[under Uniform Trust Code Section 701];
- (2) giving of bond to secure performance[under Uniform Trust Code Section 702];
- (3) reasonable compensation[under Uniform Trust Code Section 708];
- (4) resignation[under Uniform Trust Code Section 705];
- (5) removal[under Uniform Trust Code Section 706]; and
- (6) vacancy and appointment of successor[under Uniform Trust Code Section 704].

Legislative Note: A state that has enacted the Uniform Trust Code (Last Revised or Amended in 2010) provisions cited in this section should update the bracketed language to refer to the appropriate provisions of that enactment. A state that has enacted relevant statutory provisions other than the provisions of the Uniform Trust Code cited in this section should replace the bracketed language with cross references to those provisions, except that a state that allows statutory commissions rather than reasonable compensation for a trustee is advised for the reasons given in the comments below to apply a rule of reasonable compensation to a trust director. A state that has not enacted relevant statutory provisions should delete the bracketed language.

SECTION 17. UNIFORMITY OF APPLICATION AND CONSTRUCTION. In applying and construing this uniform act, consideration must be given to the need to promote uniformity of the law with respect to its subject matter among states that enact it.

SECTION 18. RELATION TO ELECTRONIC SIGNATURES IN GLOBAL AND NATIONAL COMMERCE ACT. This [act] modifies, limits, or supersedes the Electronic Signatures in Global and National Commerce Act, 15 U.S.C. Section 7001 et seq., but does not modify, limit, or supersede Section 101(c) of that act, 15 U.S.C. Section 7001(c), or authorize electronic delivery of any of the notices described in Section 103(b) of that act, 15 U.S.C. Section 7003(b).

SECTION 19. REPEALS; CONFORMING AMENDMENTS.

(a)

(b)

(c)

SECTION 20. EFFECTIVE DATE. This [act] takes effect

I. Why Use A Directed Trust?

- A. Control over investments, distributions and other decisions. Many clients prefer to vest control over key decisions in the hands of trusted family or advisors while leaving all other decisions in the hands of a professional trustee. The following are common situations:
1. A client seeking to hold some or all of a family business in trust may prefer to confer on a close friend, relative or trusted advisor, the power to vote the shares held in trust or otherwise exercise managerial control over the company.
 2. Similarly, if the client wishes to hold special assets in trust, a corporate trustee may insist that it be directed as to those special holdings because otherwise the trustee may be liable for failure to diversify or failure to meet its duty of prudence and care with respect to such investment.
 3. Another common situation is where the client prefers a corporate trustee to manage the record keeping and accounting but wants someone closer to the family to make decisions about distributions.
 4. A corporate trustee may provide nexus to a particular trust jurisdiction but the client has a long standing relationship with other advisors who the client prefers to make key decisions rather than the unfamiliar corporate trustee.
- B. Lower trustee fees. In Delaware and other states with directed trust statutes, trust companies have lowered their fees where they are directed. Many charge annual flat fees ranging from \$5,000 to \$10,000. When compared to basis point fees, this can translate into large savings.

- II. Trust Modification. In order to convert a fully managed trust to a directed trust, the trust will need to be modified to authorize an advisor to direct the trustee on specified trustee powers, exonerate the directed trustee for loss on account of following directions, and compensate the advisors, among other things. A trust can easily be amended if so provided in the trust agreement. In the absence of any trust provisions authorizing trust amendment, a trust, nevertheless, may be able to be amended under state law. If the existing jurisdiction governing the trust does not readily permit trust amendments, it is often possible to move the situs of the trust and change the law governing the administration of the trust. This may be accomplished by removing and replacing the existing trustee with a resident trustee in a state with flexible amendment laws. Under Delaware law, for example, once a Delaware-based trustee is in office and the trust is being administered in Delaware, the laws of Delaware govern matters of trust

administration, including the four main non-judicial methods of modifying a trust.¹ Once the trust administration is governed by the laws of a state which permits trust amendments, the trust can then be amended in accordance with such state laws. Four non-judicial methods of modifying a trust are summarized below.

A. Non-Judicial Settlement. UTC § 111 provides in pertinent part that interested persons may enter into a binding non-judicial settlement agreement with respect to any matter involving a trust, to the extent it does not violate a material purpose of the trust and includes terms and conditions that could be properly approved by the court or other applicable law.² UTC § 111(d) provides a non-exclusive list of matters that may be resolved by the non-judicial settlement, including, among others, matters related to: the direction to a trustee to refrain from performing a particular act or the grant to a trustee of any necessary or desirable power; the resignation or appointment of a trustee and the determination of a trustee's compensation; and liability of a trustee for an action relating to the trust.³ These types of changes would be required to convert a trust into a directed trust. Nevertheless, some practitioners may feel hesitant to modify a trust in a manner not identified in UTC § 111(d) or where there is no dispute or disagreement among the parties.

1. All of the states that have adopted UTC § 111 (except Kansas), and several additional states that have not adopted the UTC, permit non-judicial settlement agreements to change the extent of trustee powers, liability and compensation.⁴ The states which have not adopted UTC § 111 (or a similar statute) are: Alaska, California, Colorado, Connecticut, Georgia, Hawaii, Indiana, Louisiana, Nevada, New York, Oklahoma, Rhode Island, South Dakota, Texas.⁵ Kansas adopted UTC § 111 in a limited form that does not permit interpretation or construction of the

¹ 12 *Del. C.* § 3332(b) (“Except as otherwise provided by the terms of a court order and notwithstanding a general choice of law provision in the governing instrument of a trust, such as a provision to the effect that the laws of a jurisdiction other than this State shall govern the trust or the administration of the trust, the laws of this State shall govern the administration of the trust while the trust is administered in this State unless the governing instrument expressly provides that the laws of another jurisdiction govern the administration of the trust and further provides that the laws governing the administration of the trust shall not change on account of a change in the place of administration of the trust.”)

² UTC § 111(b), (c) (2010).

³ UTC § 111(d) (2010).

⁴ Todd A. Flubacher and Thomas R. Pulsifer, *The Delaware Advantage* (2017) (on file with author) Overview of State Statutes Permitting Modification of Irrevocable Trusts chart at pp. 1-5, identifying such matters as a “wrapper.”

⁵ Todd A. Flubacher and Thomas R. Pulsifer, *The Delaware Advantage* (2017) (on file with author) Overview of State Statutes Permitting Modification of Irrevocable Trusts chart at pp. 1-5.

terms of the trust, direction to a trustee to refrain from performing a particular act or the grant to a trustee of any necessary or desirable power.⁶

2. Delaware Non-Judicial Settlement Agreement Requirements

- a. Under Delaware law, which is based on UTC § 111, the non-judicial settlement agreement may not violate a “material purpose” of the trust.⁷ The non-judicial settlement statute does not define the term “material purpose.” There seems to be a consensus in Delaware among practitioners that a material change to the dispositive provisions or tax provisions of a trust could violate a material purpose of the trust, whereas a change to the administrative provisions generally would not violate a material purpose of the trust. No Delaware cases address this issue, to date.
- b. All “interested persons” must sign the agreement.⁸ Interested persons are, generally, those whose interest in the trust would be affected by the proposed non-judicial settlement agreement, including:
 - i. Trustees and other fiduciaries;
 - ii. Trust beneficiaries, who will generally be those with a present interest in the trust and those whose interest in the trust would vest, without regard to the exercise or nonexercise of any power of appointment, if the present interests in the trust terminated on the date of the non-judicial settlement agreement;
 - iii. The trustor of the trust, if living; and
 - iv. All other persons having an interest in the trust according to the express terms of the governing instrument (such as, but not limited to, holders of powers and persons having other rights, held in a nonfiduciary capacity, relating to trust property).
 - v. Contingent interests may be represented in compliance with the virtual representation statute.⁹

⁶ Todd A. Flubacher and Thomas R. Pulsifer, *The Delaware Advantage* (2017) (on file with author) Overview of State Nonjudicial Settlement Agreement (NJSAs) Statutes chart at pp. 23-32.

⁷ 12 *Del. C.* § 3338(c).

⁸ 12 *Del. C.* § 3338(a).

⁹ 12 *Del. C.* § 3547.

- c. The agreement may resolve any of the following matters, which include, but are not limited to the following:¹⁰
 - i. The interpretation or construction of the terms of the trust;
 - ii. The approval of a trustee's report or accounting;
 - iii. The direction to a trustee to refrain from performing a particular act or the grant to a trustee of any necessary or desirable power;
 - iv. The resignation or appointment of a trustee and the determination of a trustee's compensation;
 - v. The transfer of a trust's principal place of administration; and
 - vi. The liability of a trustee for an action relating to the trust.
- d. The court's approval is not required but any interested person may "bring a proceeding in the Court of Chancery to interpret, apply, enforce, or determine the validity of a non-judicial settlement agreement" including whether any virtual representation was adequate.¹¹

B. Non-Judicial Modification

- 1. UTC § 411(a) provides, in part, that a noncharitable irrevocable trust may be modified or terminated upon consent of the settlor and all beneficiaries, even if the modification or termination is inconsistent with a material purpose of the trust.¹² Some states allow such modification or termination without approval of the court, and others require court approval.
 - a. The jurisdictions which have adopted UTC § 411(a) (or a similar statute) which do not require court approval for modification are: Arkansas, California, Delaware, District of Columbia, Florida, Iowa, Kansas, Kentucky, Michigan, Minnesota, Mississippi, Missouri, Montana, New Jersey, New Mexico, New York, North Carolina, Pennsylvania, South Dakota, Tennessee (only allows

¹⁰ 12 *Del. C.* § 3338(d).

¹¹ 12 *Del. C.* § 3338(e).

¹² UTC § 411(a) (2010).

modification during settlor's lifetime), Utah, Vermont, Wisconsin and Wyoming.¹³

2. Delaware Non-Judicial Modification Requirements. Non-judicial modification is available under Delaware law even if it may violate a material purpose of the trust.¹⁴ The agreement must be made with the written consent or written nonobjection of the trustor, all then serving fiduciaries and all beneficiaries.
 - a. The term "beneficiaries" is undefined but, under common law principles, includes contingent and remote beneficiaries.¹⁵ Contingent interests may be represented in compliance with the virtual representation statute.¹⁶
 - b. If there is more than one settlor, all settlors must consent or provide a written nonobjection.¹⁷ If a settlor is incapacitated an agent under a power of attorney may consent or provide a written nonobjection on behalf of the settlor, if expressly authorized to do so under the power of attorney or under the terms of the trust agreement.¹⁸ A court appointed guardian may also sign on behalf of an incapacitated settlor with court approval.
 - c. The modification may include any provision that could have been included in the governing instrument of the trust were such trust created upon the date of the modification.
 - d. The court's approval is not required but any interested person, including the trustor, may "bring a proceeding in the Court of Chancery to interpret, apply, enforce, or determine the validity of a modification" including determining whether any virtual representation was adequate.¹⁹

¹³ Todd A. Flubacher and Thomas R. Pulsifer, *The Delaware Advantage* (2017) (on file with author) Summary of State Statutes That Generally Permit Modification By Consent of Parties To Noncharitable Irrevocable Trusts chart at pp. 18-22.

¹⁴ 12 *Del. C.* § 3342.

¹⁵ *Restatement (Third) of Trusts*, § 48.

¹⁶ 12 *Del. C.* § 3547.

¹⁷ 12 *Del. C.* § 3342(a).

¹⁸ 12 *Del. C.* § 3342(a).

¹⁹ 12 *Del. C.* § 3342(c).

- e. An interested person may waive the right to contest the modification.²⁰

C. Decanting

1. Decanting involves an exercise of the trustee's discretion to distribute trust principal to the trustee of another trust for the benefit of one or more of the beneficiaries of the first trust. Twenty-five jurisdictions have enacted decanting statutes, which vary considerably. Some are more restrictive than others. Some require consent of, or notice to, beneficiaries or court approval. Others do not.
2. Delaware Decanting Requirements.
 - a. Generally, under Delaware law, the trustee must have discretionary authority to distribute trust principal or trust income; the decanting power is limited to the property over which the trustee has authority to distribute.²¹ It cannot be used, for example, to decant trust principal if the trustee is authorized to make discretionary distributions of only trust income.²²
 - b. Trust must be decanted in favor of one or more current beneficiaries.
 - c. Notice to beneficiaries is not required.
 - d. The decanted trust should include any ascertainable standards set forth in the first trust.
 - e. The decanted trust may include a new general or limited power of appointment exercisable by any of the current permissible beneficiaries of the first trust.
 - f. The decanted trust cannot accelerate distributions to or among members of an open class of beneficiaries (e.g., a person's living descendants) or permit distributions which exceed amounts permitted under the governing instrument for the first trust.
 - g. The trustee can create a new trust to receive the existing trust fund. Additionally, a trustee may decant under the same trust instrument,

²⁰ *Id.*

²¹ 12 *Del. C.* § 3528.

²² 12 *Del. C.* § 3528.

as modified by the decanting, rather than decanting to an entirely new trust instrument.²³

- h. Limitations apply to minor's trusts, marital trusts, trusts with certain powers of withdrawal so that tax benefits are not invalidated under the decanted trust:
 - i. A decanted minor's trust must vest and become distributable no later than the date upon which such interest would have vested and become distributable under the terms of the governing instrument of the first trust.
 - ii. The income or unitrust interest of a trust for which a marital deduction was taken cannot be reduced as a result of the decanting.
 - iii. Decanting is not allowed with respect to trust property subject to a presently exercisable power of withdrawal held by a sole current beneficiary.
- i. The original trust agreement must not expressly prohibit decanting.

D. Merger

- 1. Merger can be used as a means to modify a trust by merging the assets of one trust into another trust having different terms. Most merger statutes require that the merger not impair the rights of a beneficiary or adversely affect the achievement of trust purposes.²⁴ Some states impose additional or different standards for merger.
- 2. Delaware Merger Requirements.²⁵
 - a. Under the Delaware merger statute, merger cannot result in a "material change in the dispositive terms of the trust defining the nature and extent of any trust beneficiary's interest in the principal or income of the trust."²⁶ This provision is intended to clarify that while some changes may impact a beneficiary's interest, the ones which are prohibited under the merger statute are limited to those that materially change the dispositive provisions relating to the

²³ 12 *Del. C.* § 3528(a).

²⁴ Todd A. Flubacher and Thomas R. Pulsifer, *The Delaware Advantage* (2017) (on file with author) Overview of State Statutes Permitting the Merger, Combination, or Consolidation of Trusts chart at pp. 13-17.

²⁵ 12 *Del. C.* § 3325(29).

²⁶ 12 *Del. C.* § 3325(29).

beneficiary's interest in principal or income, such as when and to what extent a beneficiary can receive distributions from the trust.

- b. Trustee may declare a new trust for the purpose of merging all or a portion of an existing trust with and into the new trust or merge existing trusts.
- c. Merged trusts do not have to be created by the same trustor.
- d. Merged trusts need not be funded prior to the merger.
- e. The merger power is exercised by the trustee without consent of or notice to beneficiaries or court approval. Notwithstanding, Delaware trustees will likely require that beneficiaries be notified of the merger and consent to it in advance.

III. Drafting and Management of Directed Trusts

A. Establish clear intent of settlor. Include clear statements about settlor's intent that the trust be directed and manage the trust accordingly.

- 1. A properly managed directed trust will require the advisor to direct the trustee with respect to specified powers. FORM 1 is a form of direction letter that can be used to direct the trustee.
- 2. The trustee should follow directions and should not engage in second guessing the advisor, with certain exceptions. The trustee should not violate the terms of the trust agreement or engage in acts of willful misconduct.
- 3. For ambiguous situations, the advisor should obtain consent of beneficiaries.

B. Identify directed powers. A drafting attorney should pay careful attention to which powers are directed to avoid gaps in advisor's authority. A best practice is to identify which of the trustee powers are to be directed rather than referring generally to "investment decisions" or "distribution decisions" as being directed.

- 1. Some powers have elements of distribution powers and investment powers, such as a loan to a beneficiary or guarantee on behalf of a beneficiary.
- 2. If the trust will hold or acquire non-marketable assets, the trust agreement should authorize the trustee to rely on informal valuations for non-marketable assets. The trust agreement should establish the procedure for directing the trustee to make any representations or warranties in connection with acquiring certain assets and signing documents without substantive review. See FORM 2.

3. Some powers do not fit neatly within distribution powers or investment powers and might best be held by a separate “trust protector.” Such powers could include the power to amend, change situs and governing law or grant a general power of appointment.

C. Who Should Not Serve As Advisor.

1. The advisor, whether an investment or distribution advisor, should not have a conflict of interest with other beneficiaries.
2. If the settlor wishes to serve as investment advisor for a directed trust where the trust is to hold a closely held company, consider vesting the voting power with respect to such company in someone other than the settlor, or name someone else as the investment advisor. There is a concern that the settlor’s retention of the power to vote with respect to such company could be a retained interest.²⁷
3. The settlor should not serve as the distribution advisor or as trust protector holding specified powers. This could be a retained interest to the extent that the settlor is deemed to hold dispositive powers of a trustee.

D. Fiduciary Capacity. Under Delaware law, an advisor is presumed to act in a fiduciary capacity unless the governing instrument provides otherwise.²⁸ It is generally considered a best practice to have an advisor serve in a fiduciary capacity. A concern is that if an advisor holds most of the trust powers without any fiduciary responsibility, then the trust may not be a trust, and perhaps may be an outright gift or an agency arrangement.

E. Exculpation. Under Delaware law, a directed trustee is not liable for loss resulting from following the advisor’s direction unless the trustee engages in an act of willful misconduct.²⁹ Further, a directed trustee has no duty to monitor the advisor, provide advice to the advisor or warn beneficiaries about instances in which the trustee would have taken a different course of action.³⁰ Accordingly, most Delaware trust companies expect the trust agreement to exculpate the directed trustee for all liability except for its own willful misconduct and waive the duty to monitor and warn.

²⁷ *Mirowski v. Comm’r*, T.C. Memo 2008-74. See also, Mitchell M. Gans and Jonathan G. Blattmachr, “Family Limited Partnerships and Section 2036: Not Such a Good Fit,” *ACTEC Law Journal*, Vol. 42:253 (Winter 2017), citing *Estate of Powell v. Comm’r*, 148 T.C. No. 18 (T.C. May 18, 2017).

²⁸ 12 *Del. C.* § 3313(a).

²⁹ 12 *Del. C.* § 3313(b).

³⁰ 12 *Del. C.* § 3313(e).

1. Some statutes can exculpate a co-trustee for all liability if the co-trustee is an “excluded trustee.”³¹
 2. The trustee should disclose to the settlor and beneficiaries the nature of trust both initially and on account statements.³²
- F. Compensation. The trust agreement should provide compensation for all fiduciaries serving.
- IV. Coordination Among Trustee and Advisors. Consider the following scenarios when drafting a directed trust.
- A. Tax Matters
1. Who Is In Charge of Tax Matters
 - a. Under 12 Del. C. § 3325(16), (17), the trustee.
 - b. Under federal law, the trustee. See Instructions for Form 1041.
 2. E.g. Due to an IRS audit, the GST trust is overfunded and does not have an exclusion ratio of zero. Who is responsible for handling this situation if the trust is silent? It may make sense to assign tax matters to the professional trustee, and include precatory language with respect to distributions from a GST exempt trust. See FORM 3.
 3. E.g. Trust acquires stock in S corporation. Who is in charge of making the S election if the trust is silent?
- B. Cash Matters - what is trustee’s duty or authority in the following situations
1. E.g. Tax payment or other administrative expenses are due but trust holds only an interest in a family LLC. See FORM 4.
 2. E.g. Trustee is being sued but holds only an interest in a family LLC. See FORM 5.
 3. E.g. Trust holds only an interest in an operating LLC and the manager issues a capital call.
- C. Coordinating Distribution Language
1. E.g. Trust agreement provides for a mandatory distribution at a certain time, but gives advisor discretion to override mandatory distribution under

³¹ 12 Del. C. § 3313A.

³² 12 Del. C. § 3585 (2 year laches following a report).

certain circumstances. Should trustee contact the advisor to determine whether advisor wishes to override each mandatory distribution?

2. E.g. Advisor has authority to direct distributions but trust is silent as to whether distributions can be made in cash or in kind. Who decides?

D. Exercise of Power of Substitution

1. E.g. The settlor serves as investment advisor and has made a completed gift of shares of stock in closely held company to the trust in 2012. The settlor now wishes to substitute marketable securities with the trust property.
2. Under Rev. Rul. 2008-22,³³ a settlor will not be treated as having a retained interest by virtue of holding the power of substitution provided that the trustee has a fiduciary obligation (under local law) to ensure that properties acquired and substituted by settlor are of equivalent value and further provided that substitution power cannot be exercised in manner that can shift benefits among trust beneficiaries.
 - a. If the trust is drafted under Delaware law, the default law is that the fiduciary responsible for investment decisions has a fiduciary duty to determine that the substituted property is of equivalent value. If there is an investment advisor, the default law would make the investment advisor responsible for this determination. If the settlor is exercising the swap power and is also the investment advisor, the settlor may fail to satisfy the terms of the revenue ruling. Therefore, it is important to override the default law under the terms of the trust agreement, as is permitted by statute, and provide that the trustee, not the investment advisor, is responsible for determining whether the swapped property is of equivalent value.
 - b. See FORM 6.

³³ Rev. Rul. 2008-22, 2008-1 CB 796 (4/17/2008) (power by itself will not cause estate tax inclusion for grantor provided trustee has fiduciary obligation (under local law) to ensure grantor's compliance with terms of this power by satisfying itself that properties acquired and substituted by grantor are of equivalent value and further provided that substitution power cannot be exercised in manner that can shift benefits among trust beneficiaries).

FORM 1

**DIRECTION LETTER WITH RESPECT TO SIGNING
REPRESENTATIONS/WARRANTIES**

Dear Administrative Trustee:

Under Article ___ of _____ Trust (the "Trust"), I am named as the Investment Adviser. _____ serves as Administrative Trustee of the Trust (the "Administrative Trustee"). Under the terms of the Trust, the Investment Adviser has full power to make all investment decisions with respect to the investment of trust property.

I hereby direct the Administrative Trustee to sign the attached _____ Agreement and to accept and retain the interest in _____ LP as described in the _____ Agreement.

I have reviewed the attached documents and, in my capacity as Investment Adviser under the Trust, approve of the terms contained in the documents. **I acknowledge that the document listed above includes certain representations, warranties and covenants made by the Trust, and I agree (a) that this direction includes my representation and warranty that the same are true and correct [based upon my actual knowledge], (b) that my responsibility as Investment Adviser of the Trust includes the responsibility to monitor the Trust's investments and the actions of the Trust, and to direct and instruct the Administrative Trustee on the future actions to be taken with respect to such representations, warranties and covenants. The Administrative Trustee shall not be obligated to monitor the Trust's investments or the actions of the Trust with respect to any such representations, warranties and covenants.**

These directions are intended by me to be directions described in section 3313(b) of Title 12 of the Delaware Code. This states, in relevant part, that if a declaration of trust provides that a trustee is to make investment decisions upon the direction of an adviser, including a trustee, and the trustee acts in accordance with such a direction, then except in cases of willful misconduct, the trustee shall not be liable for any loss resulting from any such act.

Sincerely,

FORM 2

DIRECTION TO SIGN AGREEMENTS AND OTHER DOCUMENTS

Additionally, the Investment Adviser shall have the power to [i] manage or participate in the management of any entity owned by the trust, to the extent such entity's governing instruments or applicable law require the trust to manage the same, [ii] direct the Trustee to make any representation, warranty or covenant required in order to make or maintain any investment of the trust, [iii] direct the Trustee to take any future action with respect to any such representation, warranty or covenant; and [iv] to direct the Trustee to sign agreements and any other documentation required in connection with the purchase of any investment and the maintenance of any such investment. The Investment Adviser shall have sole responsibility (and the Trustee shall have no responsibility) for the exercise of the foregoing powers. The Trustee shall not be required to sign any document that purports to be based on the Trustee's actual knowledge if not true, that is impossible for the Trustee to carry out, or that violates any law or regulation applicable to banks, trust companies or sophisticated investors.

FORM 3

GENERATION-SKIPPING TRANSFER TAXATION PROVISIONS

It is the Grantor's intention that the Trustee consult with the executor of the Grantor's estate to determine whether the trusts hereunder shall be entirely exempt from generation-skipping transfer tax. In furtherance of the Grantor's intention:

A. Power To Act The Trustee is authorized: (1) to hold any property immediately upon receipt in a separate trust, pending allocation of the transferor's GST exemption; or (2) to divide any property held in trust (including any terminating trust) or directed to be held in trust (whether or not immediately upon receipt) into two or more separate trusts of equal or unequal value, each of which shall be held as a separate trust.

B. Division of Trust If, upon the death of any beneficiary of a trust hereunder, the assets of the trust are includible in the beneficiary's gross estate for federal estate tax purposes, the Trustee may divide such trust into separate trusts so that one such trust is equal in value to the amount of GST exemption the legal representatives of the beneficiary's estate intend to allocate thereto. The Trustee is further authorized, to the extent permitted by law, sever any trust hereunder in a "qualified severance" within the meaning of Section 2642(a)(3) of the Code. Any division of property into shares pursuant to this Agreement, whether pro rata or non-pro rata, shall be made in such manner as to comply with all Treasury Regulations promulgated under the Code, so that appreciation and depreciation in the property prior to actual division are fairly represented in each share.

C. Combination of Trusts The Trustee is authorized to combine (1) separate trusts hereunder with the same dispositive provisions for the same beneficiaries into a single trust, or (2) the assets of any trust hereunder with those of any substantially similar trust, as the Trustee, in its sole and absolute discretion, shall determine, for the same beneficiaries under another instrument, either by transferring such assets to the trustees of such other trust to be held as part of such other trust, or by accepting from the trustees of such other trust assets thereof to hold as part of a trust under this trust agreement; provided, in each case, that an exempt trust and a non-exempt trust may not be combined. If two or more trusts (each an "original trust") are combined pursuant to the provisions of this paragraph and one or more of such original trusts were subject to any rule against perpetuities or similar rule in any jurisdiction, the earliest termination date applicable to such original trusts shall govern the termination of the resulting combined trust.

D. Distribution Adviser Any provision to the contrary notwithstanding, the Grantor requests but does not require that the Distribution Adviser refrain from directing discretionary distributions of income and principal from an exempt trust that could instead be made to the same person from a non-exempt trust without incurring any generation-skipping transfer tax on the distribution.

E. Liability of Trustee and Distribution Adviser Any action taken by the Trustee or Distribution Adviser pursuant to the provisions of this Article with respect to any trust shall be conclusive on all persons then or thereafter interested in such trust, and the Trustee or

Distribution Adviser, as the case may be, shall have no liability if, in light of or as a result of subsequent events, a different action would have caused a better tax result.

FORM 4

TAX MATTERS INVOLVING CUSTODIANS

The Trustee shall provide all information with respect to a trust necessary to enable each trust beneficiary to prepare his or her federal and state income tax returns. During any time that a bank, broker, custodian, investment counsel, money manager or others holding trust assets retained hereunder (“custodians”) has custodial responsibility for all or any portion of the assets of a trust created hereunder, the periodic statements of account provided to the Trustee by such custodians shall be considered the records of the Trust and the Trustee may rely upon them without independent examination. The duty of the Trustee to provide tax reporting information to beneficiaries shall be limited, with respect to the trust property for which such custodians have responsibility, to the extent that the Trustee does not receive the necessary information in a timely fashion from such custodians. The duty of the Trustee to prepare and file or cause to be prepared and filed any required federal or state income tax returns or any other required tax returns and to pay any taxes due (including, but not limited to estimated taxes) shall be limited, with respect to the trust property for which such custodians have responsibility, to the extent the Trustee does not receive the necessary information in a timely fashion from such custodians or it is not provided with the necessary funds required to pay any taxes due (including, but not limited to estimated taxes) from such custodians.

FORM 5

INSUFFICIENT FUNDS FOR LEGAL PROCEEDING

In the event that the Trustee reasonably believes that the marketable assets of the trust will not be sufficient to fully indemnify the Trustee with respect to its obligation to defend or to continue to defend the trust or its assets in an action in which the claimant seeks, through the exercise of judicial process or otherwise to reach the assets of the trust (including, but not limited to, situations where the action or litigation was initiated by the Trustee, and/or where such claimant is a defendant in such a litigation and raises a counterclaim against the Trustee or the assets of the trust, and/or where such claimant is a third party in such a litigation and raises a cross claim against the Trustee or the assets of the trust), the Trustee shall promptly give written notice thereof to each beneficiary and Investment Adviser of such trust whereupon the Investment Adviser shall use reasonable best efforts to obtain the funds necessary to make such payments through other means, such as borrowing the funds and/or securing the loan with trust assets. If the Investment Adviser notifies the Trustee that other means of obtaining such funds are not reasonably available, the Trustee shall request the beneficiaries, jointly and severally, to pay in full for all liabilities and expenses of such defense (including without limitation the professional fees and expenses of counsel, accountants and expert witnesses) with such security for their obligation to make such payments as the Trustee may reasonably require in its sole discretion. The beneficiaries shall have no duty or obligation to pay for such liabilities and expenses or provide security therefor. For purposes of this Declaration, “defend or continue to defend” includes without limitation participating in, intervening in, or defending a lawsuit, action in equity or administrative, arbitration or mediation proceeding, including any counterclaim brought by a defendant in a litigation initiated by Trustee or any cross-claim brought by a third party in any litigation (collectively, a “proceeding”), or taking any other action to resist such claim. In the event that the beneficiaries refuse to agree to undertake to pay, or having so agreed, in the event the beneficiaries fail to perform their obligations to pay, for such liabilities and expenses or provide security therefor, the Trustee shall be entitled to withdraw from the proceeding involved without liability, including without limitation even if such withdrawal may result in the granting or award of relief against the trust or its assets (including without limitation a distribution of trust assets) in satisfaction of the claims being made therefor.

Notwithstanding the foregoing in the subparagraph above, if the Trustee initiates litigation on behalf of the trust and if one or more defendants in such litigation raise a counterclaim against the Trustee or the assets of the trust or one or more third parties raise a cross claim against the Trustee or the assets of the trust, the Trustee shall not have the right to withdraw from such proceeding if the amount of the counterclaim and/or such cross claim, as the case may be, is or are less than the amount claimed against the defendant by the Trustee. Nor shall the Trustee shall have the right to withdraw from such proceeding if the amount of the counterclaim and/or cross claim exceed(s) such amount claimed by the Trustee, unless the Trustee reasonably believes that all the assets of the trust, whether readily marketable or not, are insufficient to satisfy any such excess.

FORM 6

POWER OF SUBSTITUTION IN DIRECTED TRUST

At any time and from time to time, without the consent of any Trustee or other fiduciary serving hereunder, the Grantor, acting in a non-fiduciary capacity, may acquire or reacquire any part or all of the property of any trust under this Agreement by substituting therefor other property of equivalent value, valued on the date of substitution. The Trustee has a duty to satisfy itself that the property acquired and substituted by the Grantor is in fact of equivalent value, and accordingly has a duty of impartiality with respect to the beneficiaries that supersedes any other provision of this Agreement. Therefore, if the Trustee believes that the property the Grantor seeks to substitute for trust property is not in fact of equivalent value, or, if the Trustee believes that the power authorized by this paragraph may be exercised to shift benefits among the beneficiaries, then the Trustee shall seek a determination by a court of competent jurisdiction to assure that the property which the Grantor seeks to substitute is of equivalent value and/or that the power is not exercised to shift benefits among the beneficiaries. The Grantor may release this power at any time by written notice to the Trustee. Any such release shall be irrevocable and shall be binding upon such Grantor, the Trustee and Adviser serving at the time of such release, and all successor trustees and advisers.

