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**Panel 10: Better Late Than Never: Directed Trusts Are
Now A Reality**

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Speakers: Phil Hayes and Michael Rosen-Prinz

Conference Reference Materials

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Directed Trusts in California: Better Late Than Never?

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A. Introduction

Directed trusts are *hot* right now. What's up with that? With a directed trust, the settlor instructs the trustee to follow the direction of, or seek consent from, another fiduciary (interchangeably called a trust advisor or trust director director) with respect to a discrete trust duty or function.² In jurisdictions with strong enabling legislation, trust companies love directed trusts because they allow the company to retain clients while minimizing (or eliminating) fiduciary risk – and duties. Directed trusts are also very popular with clients because they allow the settlor or beneficiaries to retain some (tacit) control over key fiduciary duties (investments and/or distributions) at **LOWER COST** (reduced corporate trustee fees).

The use of directed trusts is limited only by the imagination of the settlor and her attorney. Directed trusts are useful, appropriate, and sometimes a necessity in several common circumstances, among them when:

- The settlor does not need the corporate trustee's investment capability, but wants its administrative capability;
- The corporate trustee, because of its duty to diversify, cannot hold a concentrated stock position;
- The client wishes to provide greater autonomy to the beneficiary, encourage entrepreneurship, private investments, beneficiary loans, etc. – which in the eyes of a corporate fiduciary may creep into investment imprudence;
- The corporate trustee balks at running a family business, hedge fund or LLC, because of the speculative nature of the investment and/or lack of expertise, and resultant unacceptable risk to the trustee; or
- The client wishes to separate administration and asset management, on the one hand, from the power to determine discretionary distributions, on the other, by naming a trusted friend, relative or trained specialist as distribution fiduciary.

As these examples imply, most directed trusts appoint a non-trustee (commonly called an "investment direction advisor") to manage all trust assets or specific trust assets ("special holdings"). Less frequently, settlors give a non-trustee ("distribution advisor") the sole power to direct beneficiary distributions, as when the settlor prefers an advisor with specialized training or better knowledge of the family dynamics and the desires of the settlor.

While bifurcating these trust duties affords greater flexibility, as we will see it can also result in a confusing and complicated jambalaya of parties, powers, duties, and attendant liabilities.

¹ Opinions expressed herein are solely the opinions of the author, **not** Northern Trust. Special thanks to Michael Rosen-Prinz for his efforts in passing the California Uniform Directed Trust Act, and in updating this outline regarding the California UDTA.

² We will use the term "director" to refer to a trust advisor or trust director throughout.

B. Burning Issues in the Contentious World of Directed Trusts

While directed trust statutes have been around since 1986 (Delaware, of course), they have only caught fire in the last 10-15 years, to the point that **forty-seven states** have now enacted directed trust enabling legislation in one form or another. The divergent approaches of the statutes are distinguished mainly by the statute's treatment of 1) the extent to which the directed trustee is exonerated for following the trust director's direction, and 2) the minimum standard of conduct imposed on third party directors. Of course, each statute must be considered in the context of the laws of the state enacted.³

1. Liability/Exoneration of Directed Trustee

There are three prevailing approaches to directed trustee exoneration, outlined below. At the extreme end of the spectrum the directed trustee may be completely exonerated from liability for following ANY direction of the trust director (e.g., Tennessee, South Dakota), and at the other end the statutes impose a duty on the directed trustee to monitor the trust director to ensure that the direction does not constitute a serious breach of the director's fiduciary duty or violate the terms of the trust (Uniform Trust Code §808).

a) The UTC

UTC 808 was the original uniform act incorporating a directed trust concept, and eventually prevailed in about 20 jurisdictions. It has now been replaced by the UDTA in the uniform acts, but several states continue to follow it.⁴ UTC 808 is the statute that trust promoters used as a bogeyman to enact more aggressive trustee exculpation statutes to attract trust company business, because (according to the promoters) it imposed an intolerable burden on the directed trustee to monitor the trust director:

§808. Powers to Direct.

(a) [N/A. re: revocable trusts]

(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.

(Emphasis added.)

³ For instance, in a state where the trustee cannot be exculpated for gross negligence (as in California), a trust director cannot be exculpated for gross negligence, either. In states allowing more generous exculpation of trustees (reckless indifference as the floor, for example), the trust advisor could likewise benefit from more protective exculpation. Remember, these are *floors* – the drafter does not need to select the broadest exculpation possible for the advisor or trustee.

⁴ Alabama, District of Columbia, Maryland, Massachusetts, Mississippi, Oregon and Pennsylvania.

The Comment confirms that a trustee has overall responsibility for ensuring that the trust terms are followed, and thus must refuse to act if the trustee knows the attempted exercise is manifestly contrary to the terms of the trust or that the attempted exercise would constitute a serious breach of a fiduciary duty owed by the holder of the power to the trust beneficiaries.

The UTC approach has been painted as dangerously unprotective of the directed trustee, to the point of irrelevance (from the risk-averse corporate trustee’s perspective), because it imposes on the directed trustee, notwithstanding the terms of the trust, *an overarching duty to monitor and judge the actions of the trust director. Modern directed trust statutes expressly negate this duty to monitor.* Given this theoretical crack in the door of liability (as exaggerated by states marketing for trust business), corporate fiduciaries avoid accepting directed trusts in UTC 808 jurisdictions, mainly because the perceived additional risk does not justify a lower trustee fee, one of the main attractions of directed trusts. The proliferation of more protective statutes facilitated this trend away from UTC 808 states.

In addition to imposing a duty to monitor on the directed trustee, the UTC also does not address many of the ancillary issues modern statutes generally confront: the duty to warn the beneficiaries,⁵ the option to petition for instructions, duties and powers that can be carved out as non-fiduciary, duty to keep beneficiaries and co-fiduciaries informed, etc.

b) “No Duty” States

At the other end of the spectrum from UTC 808 lie the states that have most aggressively pursued trust company business by permitting settlor to completely exonerate the directed trustee from any liability for following the director’s direction (except with respect to the administrative duties associated with carrying out the direction).⁶

An example of the “no duty” approach can be found in Iowa Code Annotated 633A.4802, recently passed by the Iowa legislature (thereby rejecting the Uniform Directed Trust Act’s “willful misconduct” scintilla of a duty approach – see below). It provides, in pertinent part:

- An excluded fiduciary⁷ is not liable, either individually or as a fiduciary, for any of the following:
- Any loss that results from compliance with a direction of the trust director, *including any loss from the trust director breaching fiduciary responsibilities or acting beyond the trust director’s scope of authority.*
- Any loss that results from a failure to take any action proposed by an excluded fiduciary that requires prior authorization of the trust director if that excluded fiduciary timely sought but failed to obtain that authorization. (Emphasis added.)

⁵ As epitomized in the notorious *Rollins v. Branch Banking Trust Co. of Va.*, 56 Va. Cir. 147 (Cir. Ct. Roanoke City 2001) opinion, where the Court upheld a directed trust provision absolving the trustee from liability for following the investment advisor’s direction, but *found the trustee liable anyway* for failure to warn the beneficiaries of the risks of the advisor’s investment in an ill-fated concentrated investment.

⁶ Alaska, Idaho, Iowa, Kentucky, New Hampshire, Ohio, South Dakota, Tennessee and Wyoming generally follow the “no liability” approach. These state statutes are somewhat derisively referred to by one commentator as “neo-trust” statutes, because they permit gaping holes in fiduciary protection for the beneficiaries. Jeffrey Schoenblum, *Directed Trusts and the Conflict of Laws* (2023), 97 Tul. L. Rev. 957.

⁷ Statutes completely exonerating the directed trustee often employ the nomenclature “excluded” fiduciary, to emphasize that the directed trustee has no responsibility whatsoever for the duties assigned to the other fiduciary.

Note that the Iowa statute addresses the elephant in the room, plugging a liability hole present in many statutes, whether “no duty” or “willful misconduct” types: it negates the duty to even evaluate whether the direction is a breach of the director’s duties, or ***even determine if the direction is beyond the trust director’s scope of authority***. This provision recognizes that with most statutes a backdoor to directed trustee liability is created when the directed trustee carries out a direction that was beyond the scope of the director’s authority, perhaps even in a “no duty” state.⁸

In these states, the common law unitary trustee concept is completely obliterated. The buck stops with no particular trustee, just a divided group of fiduciaries with individual duties, none having any oversight responsibility over the other. The first draft of the Uniform Directed Trust Act (UDTA) used this “no duty” approach. Practical political considerations⁹ forced the drafting committee to reconsider and pivot to a “willful misconduct” statute, preserving an umbrella scintilla of duty for the directed trustee over all aspects of trust administration. Indeed, the question remains even in “no duty” states: in bad facts situations, will courts find some traditional common law duty or invoke an equitable doctrine to hold a trustee accountable? Some commentators and many states¹⁰ are uncomfortable with this departure from common law, and question its ultimate effectiveness, given the maxim that “equity will not suffer a wrong to be without remedy.”¹¹

c) Willful Misconduct States/UDTA

In willful misconduct states, the unitary trustee concept survives, but just barely. In these states (including most states that have enacted the UDTA), fiduciary responsibility for a power of direction attaches primarily to the trust director, with a diminished minimum mandatory duty to avoid willful misconduct applying to the directed trustee.

These statutes¹² generally absolve the trustee from any duty to monitor the conduct of the director or director; to provide advice to, or consult with, the director; and the warn the beneficiaries. They also exculpate the directed trustee from liability for anything less than willful misconduct or bad faith in carrying out the instructions of the trust director. As referenced above, the Uniform Law Commission drafting committee, after flirting with a “no duty” approach, ultimately chose to follow this path, as forged by Delaware, and preserve a scintilla of potential liability for the directed trustee in the UDTA. The UDTA drafting committee concluded that preserving fiduciary duties applicable to the trust director (discussed below), plus a minimum standard of conduct in the trustee to avoid willful misconduct,

⁸ Likewise, South Dakota Codified Laws Ann Section 55-1B-2(1) provides that an excluded fiduciary is not liable for any loss from the trust advisor breaching fiduciary responsibilities or acting beyond the trust advisor’s scope of authority. South Dakota’s statute no doubt provided the inspiration for Iowa’s approach.

⁹ As in, why would a state that had already declined to enact a “no duty” statute now enact a “no duty” UDTA?

¹⁰ Including California, which squelched the California Bar Association’s 2011 Legislative Proposal to enact a “no duty” statute.

¹¹ This concern is reflected in the (anecdotal) hostility the federal overseer of national banks, the OCC, holds for all directed trusts, but especially “no liability” statutes. Thus, most trust companies operating in states aggressively pursuing this business have state-chartered banks operating in those jurisdictions.

¹² Delaware and the 17 states that have passed the UDTA. While Nevada is usually lumped into the “no duty” category (because its statute provides that that the directed trustee shall have no liability), another provision of the trust code, NRS Section 163.004, does not “authorize the exculpation or indemnification of a fiduciary for the fiduciary’s own willful misconduct or gross negligence.” Therefore, arguably, the trustee’s baseline fiduciary duty can never be fully negated in Nevada, and therefore it belongs in the Willful Misconduct group – or *even* with less protective states if exculpation for gross negligence is not permitted.

provides more “aggregate fiduciary duties” owed to the beneficiary, thus making the UDTA easier to pass in states that had balked at enacting “no duty” directed trust statutes (e.g., California).

While the UDTA ostensibly followed the Delaware approach by imposing a minimum standard of conduct to avoid willful misconduct, it did so in a subtly different way. Where the Delaware statute permits exoneration of the directed trustee except in cases of willful misconduct *on the part of the trust director* in complying with the direction,¹³ the UDTA in Section 9(b) permits exoneration except to the extent that *by complying with the direction* the trustee would engage in willful misconduct. The UDTA’s focus *on the direction, rather than the trustee’s own behavior*, has led some commentators¹⁴ to observe that the UDTA’s focus imposes associative liability on the trustee for the *trust director’s* willful misconduct, something akin to UTC 808 liability, avoiding which is the whole point of enacting a more protective uniform statute.

BTW: What is Willful¹⁵ Misconduct?

The UDTA’s incorporation of “Willful misconduct” confirmed its place as the gold standard for minimum standard of directed trustee liability, piggybacking on Delaware’s standing as the most popular directed trust jurisdiction. The UDTA, however, does not define “willful misconduct,” leaving it to the states to craft their own definition (or to use a higher liability floor, such as gross negligence).

Delaware defines it as “*intentional wrongdoing, not mere negligence, gross negligence or recklessness*” and further defines “*wrongdoing*” as “*malicious conduct or conduct designed to defraud or seek an unconscionable advantage.*” How will other states define Willful Misconduct? How will judges in equity interpret it? Will they impose the scienter requirement of Delaware’s definition, or will equity draw in more reckless but not malicious behavior?

2. Trust Director’s Minimum Standard of Conduct

The other main point of divergence among the states is the status of the trust director and thus the director’s applicable standard of conduct. State statutes are, unsurprisingly, inconsistent on this issue: most states mandate that the director acts as a fiduciary and is subject to some minimal standard conduct appropriate for a fiduciary. This is logical, since the director is standing in the shoes of the trustee with respect to one or more duties traditionally carried out by the trustee.

Beware the “Empty Chair”: Some states, inexplicably, leave open the possibility that the trust director can be a *non-fiduciary*, which would reduce the aggregate duties owed to the beneficiaries below a baseline fiduciary level.¹⁶ In that case, either the directed trustee is soaking up those duties (*not* what they signed up for), or the “trust” is not a trust, but some

¹³ Del. C. Section 3313 (b)

¹⁴ See, e.g., Jane Ditelberg, *Am I My Brother’s Keeper?* (2019) 44 ACTEC Law Journal No. 2.

¹⁵ Or, in Delaware, “Wilful” (sic).

¹⁶ For example, 12 Del. Code § 3313(a) provides: 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 decision of the fiduciary, such persons shall be considered to be advisers and fiduciaries when exercising such authority provided, *however, that the governing instrument may provide that any such adviser (including a protector) shall act in a nonfiduciary capacity.* (Emphasis added.)

other agency animal.¹⁷ In fairness to these states, it is possible that the traditional “trust protector” falls within the ambit of their statute, and thus a non-fiduciary may be governed by the statute. This is unfortunate, as trust protectors are a whole separate animal from trust directors, having descended from the world of offshore trusts, where the protector is generally given not the duties of a traditional trustee, but acts as an agent for the settlor (the power to remove and replace the trustee, the power to amend the document to cure ambiguities, etc.).¹⁸ By opening the door to the possibility of a non-fiduciary director, practitioners may be tempted to label a trust director’s duty as non-fiduciary in order to placate a proposed director who balks at assuming true fiduciary duties.¹⁹

UTC 808, while it *presumes* that a director is a fiduciary, does not expressly address the trust director’s minimum standard of conduct. As the UTC permits exculpation of a trustee for gross negligence,²⁰ it’s likely that the same floor applies to directors.

The UDTA addresses the fiduciary status of the trust director/director, and the applicable minimum standard of conduct, in Section 8. Under that section, the duty of a trust director is the duty of a trustee in a like position under similar circumstances: a trust director is a fiduciary with the same default and mandatory fiduciary duties with respect to a power of direction that would apply to a trustee if the trustee had the same power, including the duty to disclose its activities to the beneficiaries and to provide information to the trustee to the extent the information is reasonably related to the powers or duties of the director or trustee. Section 8 thereby *absorbs existing state trust fiduciary law that would apply to a trustee* and applies it to a trust director; the trust director is likewise subject to the same rules as a trustee with respect to an exoneration clause.

C. The Uniform Directed Trust Act

As states pandered to trust companies, racing to enact their own, unique versions of “more protective” directed trust statutes, the bland uniformity (and perceived inadequacy) of UTC 808 gave way to a disarray of competing statutes perceived to be more protective of directed corporate trustees. Thankfully, the UTC asserted itself and in 2017 enacted the Uniform Directed Trust Act, which aimed to

¹⁷ If the trust instrument provides that the trust director is not a fiduciary, and the directed trustee is nonetheless completely absolved from liability for following the adviser’s direction, the duty assigned to the advisor has fallen through the cracks – no one has a fiduciary duty to carry out that duty. For the trust to be valid, someone must have fiduciary responsibility for that job – and if there’s any doubt, chances are the corporate “directed” trustee will be the one held responsible.

¹⁸ The UDTA addresses this issue, at least in part, by carving out the traditional trust protector duty to remove and replace a trustee from its ambit in Section 5(b)(2); Cal. Prob. Code section 16606. Other powers carved out of the statute include: powers of appointment, a swap power held in a non-fiduciary capacity for federal grantor trust purposes, the settlor’s power over a revocable trust. UDTA §5(b); Cal. Prob. Code §16606.

¹⁹ Likewise, California attorneys are understandably tempted to label a trust advisor as a non-fiduciary, to avoid exposing the trust to California fiduciary income tax. This may be legitimate with traditional trust protector powers (e.g., remove and replace trustee, amend the trust to cure drafting errors), but if the “protector” has traditional trustee powers (e.g., direct or approve investments) that creep into trust advisor/director space, labeling the protector as non-fiduciary will not carry much weight with the Franchise Tax Board. If it walks like a duck...

²⁰ UTC section 1008 provides that a trustee may be exculpated for breach of trust, but not for breaches committed in *bad faith* or with *reckless indifference* to the purposes of the trust or the interests of the beneficiaries. Thus, in UTC states a trustee *may be exculpated for gross negligence*.

resolve, once and for all, the issues discussed above. The author was an observer and participant at the drafting meetings. Outlining the UDTA (citations to California UDTA):

a) Nomenclature:

- A power held by a non-trustee is called a “power of direction” Prob. Code §16602(d)
 - Significantly, and innovatively, note that a **power to appoint or remove a trustee or trust director** is NOT a “power of direction” under the act, as this power is customary in drafting practice and arose separately from the phenomenon of directed trusts. Prob. Code §16606(a)(2).²¹
 - Unless otherwise provided, such a powerholder therefore is NOT a fiduciary and, presumably, would resolve the recurring California fiduciary income tax issue with traditional trust protectors (namely, is a protector with the power to remove and replace a “fiduciary” under Rev. and Tax Code section 17742?).
 - The only limit on the exercise of a power to appoint or remove a trustee is that it must conform to any valid requirements of limitations imposed by the trust terms. Rest. (Third) of Trusts §37 cmt. A (am. Law Inst. 2003).
- The holder of the power is called a “trust director” (even if the terms of the trust call the person an “director” or “protector”). Prob. Code §16602(g).
- A trustee subject to the power is called a “directed trustee.” Prob. Code §16602(c).

b) Minimum Fiduciary Safeguards:

- A trust director has the same default and mandatory fiduciary duties with respect to a power of direction that would apply to a trustee if the trustee had the same power, including the duty to disclose its activities to the beneficiaries and to provide information to the trustee to the extent the information is reasonably related to the powers or duties of the director or trustee. Prob. Code §16612(a).
- At a minimum, a directed trustee only has a duty to take reasonable action to comply with a direction (the manner of compliance) and is liable only to the extent that *by complying with the direction the trustee engaged in “willful misconduct” (the decision whether to comply)*. Prob. Code §16614.
 - Thus, the committee chose to follow the Delaware approach, which imposes a scintilla of a fiduciary duty on the directed trustee.
 - Query whether the duty not to engage in willful misconduct and not to comply with directions outside the director’s power of direction is much different than UTC 808’s duty to not carry out directions “manifestly contrary” to the terms of the trust?
 - In doing so, the drafting committee rejected the approach of the majority of “more protective” states, which fully relieve a directed trustee from

²¹ Note that Delaware, which permits an “adviser” to be a non-fiduciary, explicitly labels trust protectors “advisers” and references powers traditionally associated with them: (1) to remove and appoint trustees, advisers, trust committee members, and other protectors; (2) to modify or amend the governing instrument to achieve favorable tax status or to facilitate the efficient administration of the trust, (3) to modify, expand, or restrict the terms of a power of appointment granted to a beneficiary by the governing instrument. 12 Del. C. § 3313(f). Presumably a trust protector/“adviser” labeled a non-fiduciary will have *no duty to exercise these powers*. In the author’s opinion this conflation of advisors and trust protectors is unnecessary and confusing.

duty or liability for complying with the direction of a trust director (including, presumably, a direction to burn the assets). The decision to apply a minimal fiduciary duty on the directed trustee was made in part for practical reasons, as the committee chairs felt that absolving directed trustees of all liability would not be popular with state legislatures (e.g., California), as well as on the belief that adding more protection of the beneficiary is more consistent with traditional fiduciary policy.

- Therefore, a beneficiary's main recourse for misconduct by a trust director is an action against the director for breach of the director's fiduciary duty to the beneficiary. The beneficiary's recourse against the trustee is only to the extent of the trustee's willful misconduct.

- Relative to a non-directed trust, the Act therefore *increases* the total fiduciary duties owed to a beneficiary. UDTA, Comment to Section 9.
- Director's Powers to veto or approve: the trustee has the normal duties of a trustee as regards the trustee's exercise of its own powers, but has only the duties of a directed trustee as regards the trust director's exercise of its power to veto or approve. UDTA, Comment to Section 9.

c) Powers of Direction Contemplated by the Act. Examples of direction powers include the power to:

- Direct investments
 - Modify, reform, terminate or decant
 - Direct a trustee's delegation
 - Change the principal place of administration, situs or governing law
 - Ascertain the happening of an event affecting trust administration
 - Determine the capacity of a trustee, settlor, director or beneficiary
 - Prosecute, defend, or join an action, claim or judicial proceeding relating to the trust
 - Grant permission to a trustee or other director to exercise a power
 - Release a trustee or trust director from proposed or past actions.
- UDTA, Section 6(a); Comment to Section 6.

d) No Duty to Monitor. A trustee has no duty to monitor the director or give advice to a settlor, beneficiary, trustee or trust director concerning instances in which the trustee might have exercised or not exercised the director's powers differently. Prob. Code §16618.

e) Cotrustees? If a settlor names cotrustees, the traditional law of cotrusteeship applies. However, the terms of the trust may apply the fiduciary duties of directed trusteeship. The cotrustee is not a trust director (the labels don't apply), but the duties and liabilities of the respective fiduciaries can correspond to those of a directed trustee and trust director. Prob. Code §16620.

f) Application. The act applies to a trust administered in an enacting state regardless of whether the trust was in existence on the act's effective date (January 1, 2024). Prob. Code §16604.

Will passage of the Act result in uniformity? The minority of states competing aggressively for corporate trust business will always try to "out-protect" the states that enact the UDTA. The rest, perhaps even the

most timorous, reactive states (e.g., California) will be persuaded to enact the UDTA, which will provide certainty to California attorneys and, perhaps, slow the flow of trust administration out of our state.

D. California's Story

For years, California lawyers drafted trusts where a trust director, protector²² or committee directed the trustee. Without the guidance of a directed trust statute, or even the much-maligned UTC 808, any trustee acting under a directed trust would not be certain that any actions taken under direction will be free from liability. A beneficiary may be able to argue that notwithstanding any language in the trust exonerating the directed trustee or setting forth a more permissive standard of care, being a “trustee” in California means that you are subject to statutory minimal standards of care for the underlying action – *notwithstanding that the trustee's hands were tied under the direction*.

In 2011, the California Bar Association passed a Legislative Proposal sponsored by the Executive Committee of the Trusts and Estates Section of the State Bar to enact a “no duty” directed trust act, based initially on New Hampshire's statute, with some uniquely Californian twists. The proposal died, ignominiously, at the Assembly Judiciary Committee. Thankfully, in 2023, the Executive Committee of the Trust and Estates Section of the California Lawyers Association (TEXCOM) tried again, this time using the UDTA, and the proposed statute, co-sponsored by TEXCOM and the California Commission on Uniform State Laws, was introduced in California as SB 801 by Senator Ben Allen. SB 801 largely preserved the terms of the UDTA, creating a new Chapter 6 (commencing with Section 16600) of Part 4 of Division 9 of the California Probate Code. Thankfully SB 801 passed, and the California Uniform Directed Trust statute (Sections 16600 et seq.) was added to the Probate Code effective January 1, 2024, applying to any fiduciary decision or action occurring after January 1, 2024 regardless of when the trust was created.

The differences between the UDTA and California UDTA are primarily cosmetic changes or the removal of redundant definitions or terms already present in California law. The most substantive change to the UDTA in the California Act consists of the **addition of Subdivision (b) of Section 16600, an introductory section making the following legislative findings before the operative provisions of the act:**

16600 (b) The Legislature finds and declares all of the following:

(1) This chapter governs an arrangement commonly known as a directed trust.

²² While there is no consistent vocabulary for the non-trustee powerholder, generally a trust advisor/director assumes a power traditionally assigned to the trustee: custody, investment oversight, administration, and discretionary distributions. A “trust protector” is often confusingly subsumed within the trust advisor or trust director concept, sharing some powers of a trust advisor but usually with a more limited mandate, and, usually, NO AFFIRMATIVE DUTY TO ACT. A trust protector is best conceptualized as an agent of the Settlor, taking action that, but for tax reasons, the settlor would have taken, e.g.: to remove and replace the trustee, to amend the trust to comply with changes in the law, to move situs or change governing law, etc. The author believes that in almost all circumstances the trust protector is a fiduciary, whether or not he or she has the duty to act (i.e., must act in accordance with the trust instruments in the best interests of the beneficiaries). Many state statutes (e.g., Delaware) lump trust protector within the ambit of the trust advisor/director role. As discussed, the UDTA distinguishes between *certain* protectors and advisors/directors, applying a lesser standard of care to a protector with the power to remove and replace the trustee. It surprises the author that states enacting the UDTA have not expanded the powers exempt from trust director status, for example, the power to amend the trust to cure ambiguities, move trust situs, or address changes in tax law. This is especially true of California, where state fiduciary income taxation rides on the characterization of the third-party powerholder as a fiduciary.

(2) *In a directed trust, the terms of the trust grant a person other than a trustee a power over some aspect of the trust's administration.*

(3) *Under this chapter, this power is called a power of direction, the person that holds the power is called a trust director, a trustee that is subject to the power is called a directed trustee, and the trust is a directed trust.*

(4) *A directed trustee is required to take reasonable action to comply with a trust director's exercise or nonexercise of a power of direction.*

(5) *Except for willful misconduct, a directed trustee is liable only for its own breach of trust in executing a direction and not for the trust director's breach of trust in exercising or not exercising the power of direction.*

This addition confirms California's adherence to the philosophy underlying the UDTA, expressed in the commentary to the UDTA, and ensures that a trustee following directions (absent willful misconduct) will be responsible solely for *that trustee's conduct* in following the direction – not the underlying decision to give the direction, which has been the subject of academic debate since the UDTA was promulgated.

The California Act also includes a number of revisions to other sections of the California Probate Code that ensure that a trust director is treated similarly to a trustee for purposes of a trust company's qualifications to serve, and the appealability of judicial orders.

E. Practical Considerations

- a) **What Really Matters?** Will a risk-averse corporate trustee, regardless of the state of administration and applicable directed trust statute, ever NOT monitor the trust director, and follow directions that it knows, for instance, exceed the powers of the trust director? Or arguably constitute some other breach of the trust?
 - The corporate trustee will almost always petition the court for instructions. It is not going to take any chances. So, does it really matter which type of modern directed trust statute they are operating under? Probably not; what most matters is the court that will be enforcing the statute. In this respect, Delaware, with its court of chancery devoted solely to corporate and probate matters, retains its primacy as the jurisdiction of choice.
- b) **The Forum is Critical.** Does this jurisdiction have a track record with difficult directed trust issues? Will the courts inject a broad equity perspective in opposition to the express terms of the trust instrument? Courts appear to be confused by directed trusts.²³
- c) **Is it a Distribution or Investment?** In practice, it is sometimes difficult to determine what powers are held by an investment director or the directed trustee with distribution power.

²³ See, e.g., *McLean v. Davis*, 283 S.W.3rd 786 (2009)(Missouri Court of Appeals finds trust protector potentially liable for failure to remove trustee, despite not having the explicit duty to review the trustee's actions); *Rollins v. Branch Banking Trust Co. of Va.*, 56 Va. Cir. 147 (Virginia Circuit Court upholds a directed trust provision absolving the trustee from liability for following the trust advisor's direction, but finds the trustee potentially liable for failure to warn the beneficiaries of the risks of the investment advisor's investment); *Shelton v. Tamposi*, 164 N.H.490 (2013)(New Hampshire Supreme Court closely parses trust agreement provisions to determine the division of duties between directed trustee and investment directors).

Some states set forth the trust director's authority and powers comprehensively.²⁴ They are, however, the exception. In states that do not define the scope of the investment director's authority:

- Can an investment director direct no-interest loans to a beneficiary? Or is that a job for the distribution advisor or the directed trustee?
- Does a directed trustee have the duty to enforce the repayment of loans? Or does that land with the investment advisor?
- Can the investment director direct formation of new entities and open accounts in the name of the entities?
- What are the respective duties of the investment director and directed trustee when litigation arises from an investment?

The burden rests with the draftsman to address these issues. Certain duties overlap, inevitably. The draftsman must attempt to clarify muddled situations.

- c) **What is an "Excluded Trustee"?** The nomenclature in the world of directed trusts is a tangled web of overlapping terms of art. The term "excluded trustee" is almost always synonymous with "directed trustee," except in Delaware and Alaska. In those states, rather than a directed trustee taking direction from a trust director, one or more trustees exercise full authority and retain full responsibility for certain trust acts, and the excluded trustee cannot participate in these acts. The excluded trustee is, in effect, *not a fiduciary* with respect to these duties.
- d) **Who Wants to be a Trust Director?** Directed trusts are founded upon the shaky premise that there's someone out there willing to take on the fiduciary duty that the corporate directed may have balked at. If the settlor wishes the trust investment director to retain a concentrated position or some other risky asset, the director should ensure that the trust instrument waives the state's prudent investor rule, as it will apply with the same force to the director as it would to the trustee. Who is representing the sister-in-law or business partner director?
- e) **Isn't There a Threshold Duty to Confirm that the Direction is Within the Scope of the Trust Director's Authority?** Yes, unless the state statute expressly negates this duty (as with South Dakota, Iowa and others – see B.1.b above). Taking this to its limit, isn't it beyond the trust director's scope of authority to commit a breach of trust? For example, if the investment trust director directs the trustee to liquidate a diversified portfolio and invest the proceeds 100% in crypto, and the TRUST INSTRUMENT DOES NOT NEGATE THE DUTY TO DIVERSIFY, isn't this a breach, and thus beyond the investment director's scope of authority? Revisiting the theme, by *negating this threshold duty* are these states annihilating the "irreducible core" of trusts, i.e., the non-waivable fiduciary obligation the fiduciaries owe to the beneficiaries? Is the trust director really free to breach its duties and the directed trustee may carry out the breach without liability (so long as the action doesn't amount to bad faith or willful misconduct by the directed trustee)? Is the "Race to the Bottom"'s nadir?
- f) **My Trust Protector has the Power to Move Situs and Amend the Document – Is She Now a Trust Director (Fiduciary) under the UDTA?** Yes, and unless you expressly negate it, she may have an affirmative duty to move situs and amend the document, rather than a mere power to do so, based on the result in the *McLean* case²⁵, which inferred a duty to act from labeling the

²⁴ E.g., Illinois, Nevada, Delaware.

²⁵ *McLean v. Davis*, 283 S.W.3rd 786 (2009).

trust protector as a “fiduciary,” notwithstanding that the trust agreement granted only a *power*, not an affirmative duty to act.



WEALTH MANAGEMENT

DIRECTED TRUSTS IN CALIFORNIA: BETTER LATE THAN NEVER?

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WHAT IS A DIRECTED TRUST?

- A trust where fiduciary powers and duties are split between the trustee and other fiduciaries (commonly known as trust directors or advisers).
 - Beware the mislabeling of a trust director as a non-fiduciary
 - Terminology is not controlling
- This is different from a traditional trust where the trustee holds all fiduciary powers and duties.
 - AKA the traditional “unitary model”
 - The OCC stands by the unitary model

WHAT DOES A TRUST DIRECTOR DO?

- A Trust Director is a non-trustee who has a “power of direction” by which the Trust Director can direct the trustee to act.
- For example, the Trust Director may have the power to direct the trustee how to invest trust assets, vote shares of stock, make distributions, or amend trust terms.
- In most states, the Trust Director’s powers are defined in the **trust instrument**

WHAT'S LEFT FOR THE TRUSTEE TO DO?

- The Trustee has a duty to take **reasonable action to carry out the Trust Director's directions** (with limits we will discuss), and exercise all powers not granted to the Trust Director.
- E.g., Trust Director may direct the Trustee as to investments, but the Trustee is in charge of distributions, as well as custody, tax compliance, record keeping, statements, reports, accountings, etc.

EVOLUTION OF DIRECTED TRUST STATUTES

- Pre-1935: Common Law, mainly Delaware (DuPont trusts)
- 1935 - Rest. 1st of Trusts
- 1986 - Delaware Statute
- 1992 - Rest. 3rd of Trusts
- 2000 - UTC §808
- Post UTC §808 Rush
 - Rational or cynical?
 - Hodge-podge of ever more corporate trustee-friendly statutes
 - 2017 – Uniform Directed Trust Act

NOW 47 STATES HAVE ENACTED DIRECTED TRUST LEGISLATION

Statutes Primarily Diverge on Two Issues:

Approach to Directed Trustee Liability

- UTC 808 – Distasteful to Corporate Fiduciaries: Too Risky?
- No Duty/Excluded Fiduciary/Neo-Trusts: Too Radical?
- Scintilla of Duty/Willful Misconduct States (Del. Since 1986) – Just Right!

Approach to Trust Director’s Standard of Conduct

- Trust Director is a Fiduciary
 - Of Course! Agents can look out for themselves
- Meretricious “Not a Fiduciary” Option
 - Wishful Thinking
 - Empty Chair: Agency, not a Trust
- Distinguish the Traditional Trust Protector

WEALTH MANAGEMENT

PROBATE CODE §16600 ET SEQ.

CALIFORNIA UNIFORM DIRECTED TRUST ACT

NEED FOR A STATUTE

- California attorneys have long drafted trusts giving certain powers and duties to non-trustees
 - “My brother Frank will have the duty to manage the strip mall and his decisions are final and binding”
- This was a practical solution, but it exposes the Trustee to liability for Frank’s breach of duty.
 - Under *Crocker-Citizens National Bank vs. Younger* (4 Cal.3d 202), the parties were treated as co-trustees, imposing a duty on the Trustee to prevent the power holder from breaching the trust
- No corporate trustee with trust powers in a state with an enabling statute would accept that risk of liability – nor would the regulators bless this arrangement

CALIFORNIA UNIFORM DIRECTED TRUST ACT (CALIFORNIA UDTA)

- From the ashes of the failed 2011 effort...
- Adds Sections 16600 et seq. to Probate Code (and certain other conforming provisions)
- Effective January 1, 2024
- Applies to any decision or action occurring after January 1, 2024 (doesn't matter when trust was created)
- Applies to a trust, wherever created, that has its principal place of administration in California

CALIFORNIA UDTA - DEFINITIONS

- ***Section 16608(a)*** ~ *the terms of a trust may grant a power of direction to a trust director*
- **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. Power of direction includes a power over the investment, management, or distribution of trust property or other matters of trust administration.
- **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.

CALIFORNIA UDTA - DUTY AND LIABILITY OF DIRECTED TRUSTEE

- ***Section 16614***

(a) Subject to subdivision (b), a directed trustee shall take **reasonable action** to comply with a trust director's exercise or nonexercise of a power of direction [...] and the trustee is not liable for the action.

(b) A directed trustee shall not comply with a trust director's exercise or nonexercise of a power of direction [...] ***to the extent that, by complying, the trustee would engage in willful misconduct.***
[...]

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

DIRECTED TRUSTEE LIABILITY: LANDED WITH THE “SCINTILLA OF DUTY”/WILLFUL MISCONDUCT (DELAWARE?) APPROACH

- Policy reasons: Trustee must bear some duty even if under direction
- Practical reasons: Would courts embrace “no liability” in unsympathetic circumstances
- Political reasons: States would balk at enacting UDTA
- Up to States to Define Willful Misconduct
 - Delaware: “intentional wrongdoing, not mere negligence, gross negligence or recklessness;” and “wrongdoing” is “malicious conduct or conduct designed to defraud or seek an unconscionable advantage”
 - California: “[u]nlike negligence, which implies a failure to use ordinary care, and even gross negligence, which connotes such a lack of care as may be presumed to indicate a passive and indifferent attitude toward results, willful misconduct is not marked by a mere absence of care. Rather, it involves a more positive intent actually to harm another or to do an act with a positive, active and absolute disregard of its consequences.” Calvillo-Silva v. Home Grocery, 19 Cal. 4th 714, 729 (1998).

ACADEMIC DEBATE PERSISTS

- Does UDTA Create UTC 808-Like Duty to Monitor the Director?
 - What is Implied by: Directed Trustee must not comply with direction “to the extent that **by complying** the trustee would engage in willful misconduct”
 - Commentators claim this creates a duty to monitor actions of trust director; i.e., associative liability
 - **Contrast Delaware:** Directed Trustee not liable “except in cases of willful misconduct **on the part of the fiduciary** so directed”
 - Do you see a subtle difference?
 - Regardless, Directed Trustees Are Not Liable Unless Their Behavior (Whether Associative or Their Own Initiative) Descends to Willful Misconduct
 - Ergo, the UDTA is still more protective of a directed trustee than UTC 808

DIRECTED TRUSTEE'S IMPLIED THRESHOLD DUTY?

Elephant in the Room: Has the Threshold Duty to Determine Whether Trust Director is Acting Within its Authority Been Negated?

- Some States, e.g. Iowa, South Dakota Have Caught On.
 - Statute explicitly provides that the directed trustee is NOT liable for following a direction that is outside the scope of the trust director's authority
- Add Language Negating This Duty in Trust Document

Another Additional Duty: Duty in Prob. Code §16614(a) to Take “Reasonable Action” to Comply With the Direction.

- **Not the same as ensuring that the direction is reasonable**

CALIFORNIA UDTA – STATUS OF TRUST DIRECTOR: FIDUCIARY

- Trust Directors are treated the same as Trustees under California law: California law regarding trustees is absorbed and applied to Trust Directors
 - **Section 16612** ~ 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
 - **Section 16612(a)(1)** ~ Trust Director **has the same fiduciary duty and liability** in the exercise or nonexercise of the power, if the power is held individually, as a sole trustee in a like position and under similar circumstances or, if the power is held jointly with a trustee or another trust director, as a cotrustee in a like position and under similar circumstances.

CALIFORNIA UDTA – STATUS OF TRUST DIRECTOR

DIRECTOR (CONT.)

- Trust Directors are treated the same as Trustees under California law
 - **Section 16622** ~ An action against a trust director for breach of trust shall be commenced within the same limitation period (and a report or accounting has the same effect on the limitation period for an action) as [...] for an action for breach of trust against a trustee in a like position and under similar circumstances
 - **Section 16624** ~ 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.

CALIFORNIA UDTA – STATUS OF TRUST DIRECTOR

(CONT.)

- Trust Directors are treated the same as Trustees under California law
- **Section 16628** ~ Unless the terms of a trust provide otherwise, the rules applicable to a trustee apply to a trust director regarding all of the following matters:
 - (a) Acceptance, (b) Giving of a bond to secure performance, (c) Reasonable compensation, (d) Resignation or removal, (e) Vacancy and appointment of a successor
- **Section 300** ~ A trust company may be appointed to act as a personal representative, guardian or conservator of an estate, **trust director**, or trustee, in the same manner as an individual[...]

HOW THE UDTA SAVED THE DAY, PART II

The Other Contentious Issue - Status of Trust Director: Fiduciary

- Absorbs Local Law of Trusteeship Regarding Standard of Duty, Exculpation of Trustee
 - Director Bears Same Fiduciary Duties as a Trustee “In a Like Position Under Similar Circumstances” in that state
 - **California and NY Trust Directors: Sorry!**
- Exception: Certain Flavors of Trust Protector May be Non-Fiduciaries
 - Swap Power – IRC 675
 - Should states expand this category?
- California: Door Shuts on Labeling a California Trust Director a “non-fiduciary” for State FIT Reasons
- Contrast with radical “Neo-Trust” States (e.g., Tennessee)

CALIFORNIA UDTA – EXCLUSIONS FROM POWERS TO DIRECT

- **Section 16606** ~ *the statute does not apply to:*
 - A power of appointment
 - The power to appoint/remove trustee or trust director
 - The power of a settlor over a revocable trust
 - The power over a trust if (a) the trust terms provide that the power is held in a nonfiduciary capacity **and** (b) the power is required to be held as a nonfiduciary to achieve the settlor's FEDERAL tax objectives (IRC §675)
- What about other reactive, trust-protector-ish powers?
Change situs, amend the document, etc.

CALIFORNIA UDTA – DUTY TO INFORM

- **Section 16616** ~ A trustee shall provide information to a trust director (and vice versa) to the extent the information is reasonably related both to the powers or duties of the trustee and the powers or duties of the trust director. A trustee that acts in reliance on information provided by a trust director (and vice versa) 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.

- ***BUT...***

CALIFORNIA UDTA - NO DUTY TO MONITOR

- **Section 16618** ~ Neither a trustee nor a trust director is obligated to monitor each other, or inform or give advice to a settlor, beneficiary, trustee, or trust director concerning an instance in which they might have acted differently.
 - This provision is standard in all state directed trust statutes – a response to the infamous *Rollins* decision

CALIFORNIA UDTA - OTHER FEATURES

- **Section 16608(b)** ~ Trust Director Powers: Trust Director May Exercise “Any Further Power Appropriate” to the Exercise of a Direction
 - E.g.: Incur costs; make reports; employ professionals to advise; prosecute, defend, join an action; delegate
- **Section 16620 ~ Cotrustees:** 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 [...].

WHAT'S NOT IN THE CALIFORNIA UDTA

- **Off-the-Rack Laundry List of Duties** or Segregated Categories of Directors
 - But see comments to UDTA with a non-exclusive list
 - Some state statutes provide
- Burden is on the Drafter to Precisely Define the Respective Powers and Duties of the Trust Director and Directed Trustee
- Guidance Regarding Discrete Boundaries Between the Trustee and Trust Director Responsibilities
 - Are Beneficiary Loans Investments?
 - Who Enforces Investment Contracts?
 - Who Settles Litigation?

WEALTH MANAGEMENT

DIRECTED TRUSTS IN PRACTICE

DIRECTED TRUSTS RULE: WHY?

- Settlers can assign responsibilities to different fiduciaries (e.g., Uncle Larry directs the trustee to make distributions, Aunt Lucy directs the trustee as to investments, the Bank acts as trustee)
- Reduced (Eliminated?) Risk for Corporate Fiduciary
- Easier for Corporate Fiduciaries to hold illiquid assets if directed
- Reduced trustee fees for professional trustees
- Freedom of Investment (“Hold the ENRON”)
- While Retaining Professional Administration (and liability?)
- Despite: the Legal Immaturity/Uncertainty of the Concept

DIRECTED TRUSTEE VS. DELEGATION

- How is giving a trust director a power of direction over investment decisions different from delegation?
- **Delegation:** A trustee may delegate investment and management functions as prudent under the circumstances. The trustee shall exercise prudence in the following: (1) Selecting an agent; (2) Establishing the scope and terms of the delegation, consistent with the purposes and terms of the trust; (3) Periodically reviewing the agent's overall performance and compliance with the terms of the delegation. [*Section 16052*]
- **Directed Trustee:** a directed trustee shall take reasonable action to comply with a trust director's exercise or nonexercise of a power of direction [...] **and the trustee is not liable for the action.** [*Section 16614*]

DIRECTED TRUSTEE VS. DELEGATION

- **Delegation:** The **Trustee** chooses to delegate an investment power, but still retains a duty to select the agent, establish the scope and terms, and review the agent's performance
- **Directed Trust:** The Settlor grants the power of direction over investments to the **Trust Director**, and the Trustee is not liable for following the Trust Director's direction.*

*Except willful misconduct...

WHAT IF YOU DON'T HAVE A DIRECTED TRUST BUT YOU WANT ONE?

- Decant under California Uniform Decanting Act (Section 19501 et seq.)
 - Must run to court and appoint a GAL...
- Modify under Section 15403 (all beneficiaries may modify trust with court petition) or 15404 (all beneficiaries and settlor can modify without court petition)
- Or move trust out of California...

DO WE NEED DELAWARE, NEVADA, ET AL. ANY MORE?

A settlor may still want to establish a trust outside of California for a number of reasons including:

- No state income tax
- Longer (unlimited) duration under perpetuities rule
- Silent/Quiet Trust (trustee can provide information to designated representative instead of beneficiaries)
- Availability of estate-remote and creditor protected self-settled irrevocable trusts
- Virtual representation statute
- Broader decanting powers / availability of nonjudicial settlements / sealed court proceedings
- Stronger no-contest clauses
- Limitation on claims period against trustees for disclosed actions
- Statutory authority for trust protectors
- Different principal and income act provisions
- And many more ...

CASE LAW

A Pattern of Confusion and End-Runs (Except in Delaware – Duemler)

- **Duemler** (Delaware)
 - Directed trustee not liable for director's lousy investment
 - Delaware so proud of this case
- **Rollins** (Virginia)
 - Directed Trustee not liable for following direction, BUT...
 - Infamous back-door directed trustee liability for *failure to warn*
- **McLean** (Missouri)
 - Court **implies**, from the (fiduciary) power to remove trustee, a duty to act to protect the trust
 - What about a (fiduciary) power to change situs?
- **Shelton** (New Hampshire)
 - Conflict over Sub-trust funding between trustee and investment directors. Illiquid investments prevented trustee from making distribution to a beneficiary

PRACTICAL CONSIDERATIONS

- Forum is **Critical**
 - Advantage Delaware
- Precise Drafting a Must
 - Who sues the beneficiary on note delinquency?
 - Who has authority to encumber trust assets?
 - Friendly Trust Co's have forms
- Is There Really Much Practical Difference Between UTC 808 and “Modern Statutes”?
 - Or is this all marketing
 - What will a California court do? Willful Misconduct is a new standard – and a *very* high bar – at least in Delaware
 - OCC hostility

PRACTICAL CONSIDERATIONS

- Who Wants to be a Trust Director?
 - Who Represents the Hapless, Patsy Trust Director
 - I.e., to ensure that the duty to diversify is nullified, that concentrations may be retained, etc.
- Will This Really Help in California, Given
 - Our State Fiduciary Income Tax Regime
 - Cf. Grantor Trusts, CA Source Income
 - Our Courts of Equity?
 - “Equity will not suffer a wrong to be without remedy”
- Future Amendments? Defining Willful Misconduct to Include Recklessness? Excluding Other Powers?



NORTHERN
TRUST