New Rules, New Tools: Directing the Undirected   
(Directed Trusts and Alternatives)

Presented by Jim Lee

*There is much 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, sometimes called an “administrative” or “directed trustee”, with regard to actions taken or directed by the nontrustee. Existing uniform trust and estates acts address the issue inadequately. Existing nonuniform state laws are in disarray.* (Prefatory Note to the Uniform Directed Trust Act.)

1. Why Directed Trusts?
   1. See “Directed Trusts from the Trust Company Perspective,” by Bridget Swartz, used and attached with permission of the author.
   2. See generally, Jocelyn Margolin Borowsky, Shaheen I. Imami, and Laura G. Mandel, “It’s Not My Fault…. They Made Me Do It: An Update on Directed Trusts,” American College of Trust and Estate Counsel, 2023 Annual Meeting, March 4, 2023, used and attached with permission of the authors.
   3. Lower trustee fees.
   4. Enable beneficiaries or settlor to retain control over investments and/or distributions.
   5. Provide liability protection for trustees not charged with certain areas of decision-making.
2. Fiduciary Duties Generally: Uniform/Arizona Trust Code
   1. A.R.S. § 14-10801 (Duty to administer trust): “[T]he trustee shall administer the trust in good faith, in accordance with its terms and purposes and the interests of the beneficiaries and in accordance with this chapter.”
   2. A.R.S. § 14-10802 (Duty of loyalty): “A trustee shall administer the trust solely in the interests of the beneficiaries. . . .”
   3. A.R.S. § 14-10803 (Impartiality).
   4. A.R.S. § 14-10804 (Prudent administration): “A trustee shall administer the trust as a prudent person would, by considering the purposes, terms, distributional requirements and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill and caution.”
   5. A.R.S. § 14-10809 (Control and protection of trust property).
3. Uniform Directed Trust Act (“UDTA”)
   1. Concepts/roles: *trust director* and *directed trustee*.
   2. Provides rules regarding fiduciary status, mandatory minimum standard of conduct, exoneration, duty to monitor, duty to share information, etc.
   3. The common law and principles of equity supplement the act, except to the extent otherwise expressly modified by the act itself or the state adopting the act.
4. State Approaches: [Overview of State Directed Trust Statutes | The American College of Trust and Estate Counsel (actec.org)](https://www.actec.org/resources/overview-of-state-directed-trust-statutes/)
5. Arizona Delegation Statutes

“**14-10807 Delegation by trustee**

A. A trustee may delegate duties and powers that a prudent trustee of comparable skills could properly delegate under the circumstances.  The trustee shall exercise reasonable care, skill and caution in:

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 actions in order to ***monitor*** the agent's performance and compliance with the terms of the delegation.

B. In performing a delegated function, an ***agent owes a duty*** to the trust to exercise reasonable care to comply with the terms of the delegation.

C. ***A trustee who complies with subsection A is not liable*** to the beneficiaries or to the trust for an action of the agent to whom the function was delegated.

D. By accepting a delegation of powers or duties from the trustee of a trust that is subject to the law of this state, an agent submits to the jurisdiction of the courts of this state.”

(Emphasis added.)

“**14-10907 Delegation of investment and management functions; duties; limitations**

“A. A fiduciary may ***delegate investment and management functions*** that a prudent investor of comparable skills might delegate under the circumstances.

B. ***A fiduciary is not responsible*** for the investment decisions or actions of the investment agent to which the investment functions are delegated ***if the fiduciary exercises reasonable care, skill and caution in selecting the investment agent***, in ***establishing the scope and specific terms*** of the delegation and in ***reviewing periodically*** the investment agent's actions in order to ***monitor*** the investment agent's performance and compliance with the scope and specific terms of the delegation.

C. ***The investment agent must comply with the scope and terms of the delegation and exercise the delegated function with reasonable care, skill and caution and is liable to the trust if the agent fails to do so.***  An investment agent who represents that the agent has special investment skills must exercise those skills.

D. An investment agent who accepts the delegation of a fiduciary's function from a fiduciary who is subject to the jurisdiction of a court of this state is deemed to have submitted to the jurisdiction of that court even if the delegation agreement provides for a different jurisdiction or venue.

E. ***A cofiduciary may delegate investment and management functions to another cofiduciary*** if the delegating cofiduciary reasonably believes that the other cofiduciary has greater investment skills than the delegating cofiduciary with respect to those functions.  The delegating cofiduciary is not responsible for the investment decisions or actions of the other cofiduciary to which the investment function are delegated if the delegating cofiduciary exercises reasonable care, skill and caution in establishing the scope and specific terms of the delegation and in reviewing periodically the other cofiduciary's actions in order to monitor the cofiduciary's performance and compliance with the scope and specific terms of the delegation.

F. Investment in a mutual fund is not a delegation of investment function and neither the mutual fund nor its advisor is an investment agent.”

(Emphasis added.)

1. Arizona Directed Trust Statute

“**14-10808 Powers to direct**

A. While a trust is revocable, the trustee may follow a direction of the settlor that is contrary to the terms of the trust.

B. ***If the trust provides that the assets in the trust are subject to the direction of the settlor or a cotrustee, beneficiary or third party, the trustee has no duty to review the directions*** it is directed to make ***or to notify the beneficiaries*** regarding any investment action taken pursuant to the direction.***The trustee is not responsible for the purchase, monitoring, retention or sale of assets that are subject to the direction*** of the settlor or a cotrustee, beneficiary or third party.***The trustee is not subject to liability if the trustee acts pursuant to the direction, even if the actions constitute a breach of fiduciary duty, unless the trustee acts in bad faith or with reckless indifference.***

C. The terms of a trust may confer on a trustee or other person a power to direct the modification or termination of the trust.

D. ***Unless the trust instrument provides otherwise, 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.)

1. Trust Director – power to direct
   1. UDTA: Trust director is a fiduciary.
      1. Fiduciary duty and liability in exercise or nonexercise of power of direction.
      2. Same duty as a trustee or co-trustee in like position and similar circumstances.
      3. Terms of trust agreement may vary duty and liability but only to the extent that such could be varied with respect to a trustee in like position and similar circumstances.
      4. Mandatory minimum standard of conduct: same as standard for nondirected trustees under state law. (No exculpation or exoneration if below this standard.)
   2. State law approaches as to a trust director. (Consider effect on an Arizona trust protector.)
      1. Main variations:
         1. Trust director is a fiduciary with the same duties as trustees (by adoption of the UDTA or some version of it) (e.g., FL, WA).
         2. Trust director is deemed to be a fiduciary and this status cannot be overridden by the trust agreement (e.g., TX).
         3. Trust director is a fiduciary *unless* terms of trust override (e.g., DE, IL, NV)
      2. Texas: The mandatory minimum standard of conduct for a trust director in Texas is good faith and adherence to the terms of a trust.
      3. Tennesee: trust director must act in accordance with terms and purposes of the trust and interest of the beneficiaries. To the extent this standard can be overridden by the trust agreement is not entirely clear. Compare Tenn. Code Ann. § 35-15-1202 (text of code) with Tenn. Code. Ann. § 35-15-1202, cmts (2013). Also, whether a trust director in Tennesee could be relieved of the duty to act in good faith could be open to debate.
      4. Delaware and Nevada: Trust director is a fiduciary with the same duties as a trustee unless overridden by trust agreement, but in all events (regardless of trust terms) subject to a mandatory minimum standard of conduct (willful misconduct).
      5. Many states have imposed mandatory minimum standards of conduct on a trust director via application of common law and establishing a willful misconduct standard for directed trustees. A minority provide that a trust director is a fiduciary with liability for breach of trust. Arguably, adoption of a willful misconduct standard for a directed trustee should result in a similar minimum standard of conduct for a trust director-fiduciary.
      6. Public Policy Query: In states where a trust director can serve as a nonfiduciary, who is the party from whom a beneficiary can seek redress if the directed trustee is absolved from liability for following the direction of a nonfiduciary trust director?
2. Directed Trustee
   1. UDTA: Directed trustee is a fiduciary.
      1. Must take reasonable action to comply with trust director’s exercise of power.
      2. Mandatory minimum standard of conduct: willful misconduct.
      3. Must not comply with a trust director’s exercise or nonexercise of a power of direction to the extent that complying with it would cause the directed trustee to engage in willful misconduct.
   2. State approaches regarding a directed trustee.
      1. Main variations:
         1. Whatever state law provides as to trustees.
         2. Willful misconduct standard (e.g., DE, IL, TX).
         3. No liability
      2. Delaware: Mandatory minimum “willful misconduct” standard for any fiduciary (including the directed trustee). Trust agreement can override common law duties, but it cannot exculpate or indemnify a fiduciary for its own willful misconduct.
      3. Texas: Requires that trustees act in good faith and in accordance with trust terms and that, absent a contrary provision in the trust instrument, a trustee is subject to all common law duties applicable to trustee.
      4. Tennesee: Trust agreement may vary/eliminate trustee duties, and courts must strictly construe statutes in derogation of common law and give maximum effect to principle of freedom of disposition and enforceability of trust instruments.
      5. Nevada:

“NRS 163.5549  Limitations on liability of directed fiduciary [directed trustee].

1.  A directed fiduciary is not liable, individually or as a fiduciary for any loss which results from:

(a) Complying with a direction of a directing trust adviser [trust director], whether the direction is to act or to not act; or

(b) Failing to take any action proposed by a directed fiduciary if the action:

(1) Required the approval, consent or authorization of a person who did not provide the approval, consent or authorization; or

(2) Was contingent upon a condition that was not met or satisfied.

2.  A directed fiduciary is not liable for any obligation to perform an investment or suitability review, inquiry or investigation or to make any recommendation or evaluation with respect to any investment, to the extent that the investment is made by a directing trust adviser.

3.  The provisions of this section do not impose an obligation or liability on a custodian of a custodial account for providing any authorization.”

* + 1. Comment regarding Nevada statute: In general, a directed trustee is not liable as a fiduciary as to those acts with respect to which it is being directed. Notwithstanding the “no liability” standard, a directed trustee may be subject to a minimum fiduciary duty to act in the interests of the trust purpose or beneficiaries with respect to the directed act. For example, Nevada has adopted a statute (N.R.S. § 163.004) that allows a trust agreement to expand, restrict, eliminate or otherwise vary a fiduciary’s powers, duties, standard of care, etc. However, that statute does *not* expressly authorize the exculpation or indemnification of a fiduciary for the fiduciary’s own willful misconduct or gross negligence. Nevertheless, in theory, if a directed trustee is considered a nonfiduciary with respect to a directed act, then ***it should be able to be indemnified*** under the terms of a trust agreement for complying with a directed act, including where its compliance was itself an act of willful misconduct or gross negligence.
  1. Excluded trustee concept — In some states this term is generally equivalent to a directed trustee. The Delaware concept of an excluded trustee is that of a nonfiduciary (see 12 Delaware Code Section 3313A).

1. Exoneration/Indemnification
   1. The directed trust statutes generally exonerate a trustee for loss for complying with the trust director’s direction, but the term “loss” is yet to be defined by courts. The term “loss” could be understood to mean a financial loss. It is unknown whether the term “loss” would refer to a distribution of trust principal where a beneficiary objects to a trust distribution.
   2. UDTA: Does not exonerate a **directed trustee** or a **trust director** for its willful misconduct. (Also, as implied above, the UDTA does not exonerate a **directed trustee** when its compliance with the instruction from the trust director is itself and act of willful misconduct.)
   3. Delaware: The statute provides that the **directed trustee** is exonerated for loss resulting from compliance with the trust director’s directions, except for the trustee’s own willful misconduct. If a trust director is not a fiduciary, it appears that a trust agreement might permit indemnification for the **nonfiduciary trust director**’s acts of willful misconduct.
   4. Nevada: The exoneration of a **directed trustee** provided by the statute applies to (1) loss resulting from compliance with a direction to act or refrain from acting; and (2) loss resulting from the trustee failing to act when the direction was subject to a condition that was not met or did not occur. Similar to Delaware, Nevada may/might permit a trust agreement to indemnify a **nonfiduciary trust director**’s acts of willful misconduct.
2. Scope of Duty to Monitor
   1. UDTA: Unless the terms of a trust agreement provide otherwise, there is no duty of a directed trustee to monitor a trust director. A directed trustee does not assume the duty to monitor merely by taking an action that could be construed as monitoring a trust director. Similarly, except as otherwise provided by trust agreement, a trust director has no duty to monitor a directed trustee. Neither a directed trustee nor a trust director assumes the duty to monitor the other merely by taking an action that could be construed as monitoring the other.
   2. State law examples:
      1. Some of the directed trust statutes explicitly waive the duty to do an investment review or provide advice in the context of an investment decision, but do not waive the duty to warn the beneficiary about the directed act.
      2. Delaware: No duty to monitor or to provide advice to or consult the trust director (advisor).
      3. NV approach: Waives what would otherwise be a trustee’s duty to evaluate the merits of an investment made by a trust director or provide advice to the trust director with respect to an investment.
3. Duty to Share Information
   1. UDTA: Unless the terms of a trust agreement provide otherwise, neither a directed trustee nor a trust director has a duty to inform or give advice to a settlor, beneficiary, or to the trust director or directed trustee (as applicable) concerning an instance in which that trustee or director might have acted differently. Neither a directed trustee nor a trust director assumes the duty to share information (inform or give advice) merely by taking an action described in the previous sentence.
   2. Delaware: No duty to warn or apprise the beneficiary. Imposes a duty to keep co-fiduciaries informed upon request.
   3. Nevada: No apparent duty.
4. Scope of Trust Director’s Investment Authority
   1. UDTA: No default statutory powers for trust directors. Per section 6, the existence and scope of a power of direction must be specified by trust agreement. Under section 6(b), a trust director is granted those further powers that are appropriate for the exercise of powers granted under the trust agreement.
   2. State law provisions: Many directed trust statutes are unclear as to the scope of a trust director’s authority and what actions constitute an “investment.” Because many directed trusts own interests in complex structures (e.g., entities with multiple layers), ambiguities can and often do arise in connection with the investment and management of those interests in directed trusts. For example, is the making of a business decision for an entity an investment decision at the trust level? Many directed trust statutes address valuation of nonpublicly traded assets as part of a trust director’s (or investment trustee’s or advisor’s) authority, but they often stop there.
5. Looking Forward: What do we want in a future Arizona directed trust statute?
   1. Trust director: fiduciary status, liability exposure, and exoneration
      1. Should an AZ statute provide that a trust director is a fiduciary as a matter of default, which can be overridden by the trust agreement, or should it be more consistent with the default nonfiduciary status of a trust protector?
      2. Should there be some mandatory minimum standard of conduct, such as willful misconduct or gross negligence, or should the standard be the same as that for nondirected trustees under Arizona law.
      3. If a trust director is a fiduciary, is exoneration or indemnification permitted under the trust agreement?
      4. If a trust director is a nonfiduciary, can a trust agreement indemnify the trust director’s acts of willful misconduct?
   2. Directed trustee: liability exposure , exoneration, and other duties
      1. Do we like the “no liability” provisions of the Nevada statute (see above), provided that there is no willful misconduct?
      2. If we adopt a “no liability” model, could a trust agreement indemnify a nonfiduciary trust director’s acts of willful misconduct.
      3. Duty to monitor?
      4. Duty to share information?
   3. Allocation of powers and responsibilities between a trust director and a directed trustee (particularly as to investment decisions):
      1. Should a trust director who is responsible for investment decisions be able to direct formation of new entities and the opening of accounts in the entities’ names?
      2. Should a trust director be empowered to direct the trustee to make loans and pledge trust assets, or to direct no-interest loans?
         1. What about loans to beneficiaries? Is that instead within the trustee’s authority to make distributions?
         2. What about the financing and pledge of assets of entities, interests of which are held in trust?
         3. What if the investment trust director is an interested party in an entity or other trust investment?
      3. Who enforces a loan if it was made by a trust director’s instruction?
      4. What if the loan is made by the corporate directed trustee’s banking department? Should beneficiaries be able to waive the potential conflict of interest of that trustee?
      5. Who directs liquidation of entities?
      6. Can a trust director tasked with investment decisions delegate its powers to their parties?
      7. What are the respective responsibilities of an investment trust director and a directed trustee when litigation arises in connection with an investment or entity (e.g., shareholder litigation)?
         1. Is the directed trustee as the named party able to take direction from the investment trust director?
         2. Can the investment trust director be designated as the named party?
   4. Can the trust agreement override or vary the effect of *any* provision of a directed trust statute?
   5. Banking / trust company perspective on these issues? (See attachment.)
6. Drafting and Administration Considerations

Below is a nonexclusive list of things to think about, both in drafting a trust instrument, and administering a trust, with directed trust provisions:

* Make sure the directed trust provisions are “woven” into the overall trust instrument and not inherently, or even impliedly, inconsistent with other provisions regarding a trustee’s powers and duties.
* Do not overreach in drafting where you know your directed trust provisions, particularly those dealing with exoneration and indemnification, go beyond what is allowed under the law of the jurisdiction. In fact, if your settlor wants maximum protection for the directed trustee or trust director, even consider abandoning the use of specific terms or limits of liability (e.g., bad faith, reckless indifference, willful misconduct) and, instead, using something like “to the fullest extent allowed under the law of jurisdiction governing the trust administration.”
* Consider addressing the reasons underlying the use of directed trust provisions in a “statement of intent” at the beginning of the trust instrument. This also puts the issue front-and-center for the settlor and may bolster a defense against a claim by a beneficiary that the settlor did not intend the harshness that might attend a particular circumstance.
* Consider limiting change of situs provisions to jurisdictions that afford the same or greater protections for directed trusts as the initial jurisdiction.
* Make sure the trust instrument clearly defines and delineates the authority and responsibility of the directed trustee and the trust director.
* Consider whether, in following the direction of the trust director, the information the directed trustee is required or allowed to receive is at odds with the directed trustee’s overall duties to the beneficiaries under the trust instrument or applicable law. Similarly, consider whether allowing the directed trustee the ability to conduct any form of due diligence might create an implied obligation to do so (even if there are statements to the contrary) and potentially undermine liability protection.
* Ensure the directed trustee is not given any discretion in deciding whether to follow the direction of the trust director – the requirement to follow such direction must be absolute. However, you also must be aware of any limits to the protection afforded to a directed trustee under applicable law (e.g., willful misconduct).
* Do not confuse a “delegated” power with a “direction to act.”
* Require that all directions from the trust director must be in writing and be: (a) clear and unambiguous; (b) complete on its face; (c) devoid of any suggestion that the directed trustee has discretion about how to take the directed action; and (d) devoid of any “catch-all” provision.
* Likewise, the directed trustee should ensure that all related communications with the trust director are in writing, as well as indicate that any request by the directed trustee for information does not constitute a waiver of any protection afforded under the trust instrument or applicable law and that such communications are only “administrative” steps necessary for the directed trustee to follow the direction.
* Differentiate between the potential liability for acting upon the direction of a trust director and potential liability for failing to follow or properly execute such direction. For example, the UDTA applies a willful misconduct standard for acting upon the direction of a trust director but requires that a directed trustee take “reasonable action to comply with a trust director’s exercise or nonexercise of a power of direction.”
* For states that have adopted a "willful misconduct" standard, how does your state define "willful misconduct?" In other words, will the standard differ in practice from state to state even if the language of those states' statutes is identical? For example, the UDTA does not define "willful misconduct," but Delaware's statute 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." The Delaware standard therefore presents a high burden to any person seeking to hold a directed trustee liable for directed actions, but other states may lack a working definition of “willful misconduct.”
* Does your directed trustee possess “special skills” that might make it more susceptible to a claim of willful misconduct?
* Some state legislatures have adopted a "no duty" standard for the directed acts of directed trustees (including Alaska, New Hampshire, Nevada, and South Dakota).

If your state has adopted a "no duty standard," are you confident that courts will reliably apply it?

* + - Or do you fear that courts in your state will be too squeamish to find that a trustee has no duty as to some aspect of trust administration and that courts may instead apply some other standard (perhaps borrowing from equity or common law) to hold the directed trustee accountable?
    - Is it possible that a "no duty" standard could present greater uncertainty for directed trustees?

Attachment: Directed Trusts from the Trust Company Perspective

by Bridget Swartz

Why directed rather than delegated?

* Perceived cost savings in fees but is it ultimately less expensive?
* Are clients/beneficiaries best served without any oversight? Who’s watching the hen house?

Why a trust company if desire directed arrangement?

* Does it make sense to have a trust company serve as directed trustee if what is directed is distribution authority?
* Fee structure arguably devalues trustee side/services-the role of the trustee becomes an afterthought.

Trust company may welcome having no responsibility with regards to what is directed but clarity regarding potential liability is paramount!

* What does Arizona’s standard of “reckless indifference” mean?
* Some trust companies will only accept on condition that laws of certain jurisdictions apply where minimal to no liability on part of directed trustee exists!
* Does the nature of the investment matter, e.g. impact investing?

Consider the role of the investment advisor in a directed arrangement.

* Is the investment advisor prepared to act in a quasi-fiduciary role?
* Who has counseled the investment advisor?
* What is the succession plan for the investment advisor?

Tight and consistent drafting important!

* Track the statutory language; do not try to draft around it.
* Don’t call it directed when it is delegated, i.e., the latter increases liability of trustee.
* If no opportunity to amend, does a bifurcation agreement afford the opportunity to create such an arrangement? With or without court approval?
* What is the so called “poison pill” if the directed arrangement fails or does not operate as contemplated or intended?