



**CANNON**  
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Estate Planning  
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Guide



# **Directed and Delegated Trusts – The Options Available and The Risks Involved**

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**Presents**

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**By**

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# Directed and Delegated Trusts – The Options Available and The Risks Involved

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## I. State Laws Regarding Directed and Delegated Trusts

### A. In General

In a directed trust, the trust instrument provides that a non-Trustee party (variously called a director, an advisor or a protector) has the power to direct the Trustee in carrying out one or more identified responsibilities. The protector has the power to direct the Trustee as to the matter under the protector's control, and often the Trustee has no discretion over that particular area of administration. Sometimes, a settlor will designate a protector to have authority over investment decisions, although a settlor may designate a protector to oversee other Trustee functions, such as distributions, as well. This arrangement is different from a delegated trust, where the Trustee contracts with another party to perform certain administrative services on the Trustee's behalf. That party acts as an agent of the Trustee, subject to the terms of the contractual relationship. *See, e.g.,* Uniform Trust Code ("UTC") § 807.

One of the most common types of directed trusts is one in which a settlor names a protector to direct investment decisions. A settlor might wish to name a family member as Trustee but may believe this person does not have the level of sophistication or time required to manage the trust's investments. Naming a protector to direct the Trustee as to the trust investments may sometimes be advisable, particularly for large trusts or those with unique assets that require special skills or knowledge. Another situation suited for a directed trust is where the settlor wishes to have many of the advantages of a corporate Trustee but simply prefers a particular individual to have superseding control over investments.

Alternatively, a settlor may wish to designate a particular Co-Trustee to have exclusive control of selected fiduciary actions. An example would be a Trustee to oversee distributions to beneficiaries. A distribution Trustee has authority over discretionary payments to beneficiaries to the extent provided by the trust instrument. An administrative Trustee may handle holding legal title to and maintaining custody of trust property, establishing and monitoring trust accounts, carrying out ministerial aspects of transactions, preparing and filing tax returns and preparing and sending accountings to beneficiaries. *See* Gordon, *Slicing and Dicing of Trustees' Duties: When and How to Use Directed Trusts*, AMERICAN COLLEGE OF TRUST AND ESTATE COUNSEL, Fall Meeting (September 15, 2008).

Although the concept of a directed trust is not new, states have only recently begun setting the statutory framework for the powers and duties of directed Trustees.

## **B. Restatement Third and the Uniform Trust Code**

Under Section 75 of the RESTATEMENT OF THE LAW (THIRD) OF TRUSTS (Restatement Third), 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 exercise of the power is contrary to the terms of the trust or the Trustee knows or has reason to believe that the exercise violates a fiduciary duty that the power holder owes to the beneficiaries. Comments to the Restatement Third discuss the difference between a director who holds the power for his or her own benefit (*e.g.*, the settlor of a revocable trust or a beneficiary with the power to prevent the sale of a residence) and a director who is acting in a fiduciary capacity for the trust beneficiaries (*e.g.*, an investment advisor with special expertise). If the director holds the power for his or her own benefit, the Trustee needs only to determine whether the exercise of the power is properly within the scope of the power, as set forth in the trust instrument. However, if the director holds the power in a fiduciary capacity, then the director essentially becomes a co-fiduciary with the Trustee, and the Trustee must verify that the director's actions do not violate a fiduciary duty. Indiana is one state that follows the Restatement approach. *See* Ind. Code § 30-4-3-9(b).

Under to Section 808 of the UTC, 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 must act in accordance with an exercise of the power unless the exercise is manifestly contrary to the terms of the trust or the Trustee knows the exercise would constitute a serious breach of a fiduciary duty that the person holding the power owes to the beneficiaries of the trust. Comments to UTC § 808(b) discuss that the powers to direct are most effective when the Trustee is not deterred from obeying the direction by fear of liability. On the other hand, the Trustee does have overall responsibility for seeing that the terms of the trust are honored. Thus, subsection (b) imposes only minimal oversight responsibility on the Trustee. Most states with directed trust statutes generally follow the UTC approach. *See, e.g.*, Fla. Stat. § 736.0808.

As stated in the comments that follow UTC § 808, the provisions of UTC § 808 may be altered in the terms of the trust. *See* UTC § 105. A settlor could provide that the Trustee must accept the decision of the powerholder without question (although there are practical limits to the effectiveness of such a provision – just as with a provision that purports to confer “sole and unfettered discretion” on a Trustee). A settlor might also provide that the holder of the power is not to be held to the standards of a fiduciary (which has distinct advantages and disadvantages).

## **II. The Nature of a Trust Protector and Whether a Trust Protector is or Should be Considered a Fiduciary**

### **A. In General**

Many settlors wish to retain as much control as possible over their trusts while protecting their assets from creditors, keeping the value of trust assets out of the settlor's gross estate for estate tax purposes and from a bankruptcy trustee should the settlor file a bankruptcy petition.

One technique that may contribute to accomplishing this objective, in addition to providing for additional flexibility in drafting the trust instrument, is to vest certain powers in a trust protector. A trust protector is a non-Trustee party that is granted powers under the trust instrument to oversee the Trustee's administration of the trust, to accommodate for future events, circumstances and changes in the law and to take appropriate action to ensure that the settlor's objectives are maintained. Generally, a disinterested third party serving as a trust protector can provide more flexibility than a Co-Trustee with specified, overriding powers because a protector may give rise to fewer conflicts of interest as well as fewer tax issues. The nature and range of powers granted to a protector can vary greatly.

The Comment to UTC § 808(b), discussed above, states that this Section "ratif[ies] the use of trust protectors." Some state statutes expressly provide for trust protectors as part of their general trust legislation. Ariz. Rev. Stat. § 14-10818; Idaho Code Ann. § 15-7-501; Mich. Comp. Laws Ann. § 700.7103(n); Mo. Rev. Stat. § 456.8-808; *see* Sherby, "'It's a Whole New Ballgame,'" Trust Directors With Powers to Advise/Consent/Direct and With Powers of Protection, AMERICAN COLLEGE OF TRUST AND ESTATE COUNSEL, Summer Meeting (2016).

## **B. Common Trust Protector Powers**

While there is no standard laundry list of powers to be given to a trust protector, following are powers commonly conferred by a trust instrument on a protector:

- Overseeing the discretionary distribution decisions or investment decisions of a Trustee, whether the Trustee is an individual or a corporate Trustee. Such power may include the power to direct or veto distributions of trust income or principal or investment decisions. This may be particularly important if the principal asset of the trust is a closely-held business interest, an art collection or other unique property. The trust instrument could provide for at least one trust protector whose consent is required for the distribution of trust property to the beneficiary, thereby limiting such beneficiary's interest so as to avoid creditor claims and to keep trust assets out of such beneficiary's bankruptcy estate.
- Removing, adding and replacing a Trustee, trust advisor or committee member without court approval.
- Adding or removing beneficiaries.
- Changing the situs and governing law of the trust, which may include the removal and replacement of Trustees to accomplish such a change.
- Consenting to the exercise of a power of appointment. The settlor may wish to provide that any exercise of a power of appointment is subject to the trust protector's consent to protect against undue influence upon the donee of the power. A trust instrument could also be drafted in such a way that a trust protector may grant a general power of appointment to a beneficiary after having examined the income and transfer tax consequences of so doing.
- Approving Trustee accounts.
- Arbitrating disputes among beneficiaries and the Trustee.



- Terminating the trust.
- Modifying a trust instrument’s administrative or dispositive provisions to maintain tax advantages, to adapt to changing circumstances involving beneficiaries or to deal with new state or federal laws or regulations. If a trust modification is within the exclusive authority of the trust protector, the Trustee ordinarily would be protected from liability for following the protector’s instructions with regard to the modification.

### C. Fiduciary Duty of Trust Protectors

There is minimal authority in the United States discussing the issue of whether a trust protector will be considered a fiduciary and if so, to what extent. *See* Bove, “The Trust Protector: Trust(y) Watchdog or Expensive Exotic Pet?,” 30 EST. PLAN. 390 (Aug. 2003). Section 808(d) of the UTC seems to indicate that a trust protector is a fiduciary: “A person, other than a beneficiary, who holds a power to direct is presumptively a fiduciary who, as such, is required to act in good faith with regard to the purposes of the trust and the interests of the beneficiaries. The holder of a power to direct is liable for any loss that results from breach of a fiduciary duty.” The use of the word “presumptively” implies that a trust instrument may provide that a trust protector is not a fiduciary. *see* Ausness, “The Role of Trust Protectors in American Trust Law,” Real Property, Trust and Estate Law Journal (Summer 2010).

In Alaska and Arizona, a trust protector shall not be liable as a fiduciary or Trustee unless provided for in the trust instrument. Alaska Stat. § 13.36.370(d); Ariz. Rev. Stat. § 14-10818(D). Michigan’s statute, however, states that a trust protector is a fiduciary to the extent of the powers and duties granted to the trust protector under the trust instrument but that the trust instrument may provide that the trust protector may exercise certain powers of administration in a nonfiduciary capacity. Mich. Comp. Laws Ann. § 700.7809(1)(a)&(2).

Although some clients may wish to specify that the trust protector is a fiduciary so that the protector must act in the beneficiaries’ best interests, the client should keep in mind a fiduciary standard may increase disputes because the beneficiaries will have the ability to enforce the trust protector’s fiduciary duty if one or more of the beneficiaries believe that duty has been violated. In addition, potential trust protectors may be less likely to serve if they know that they will be subject to a fiduciary standard. Ausness, *supra*. Some Trustees lack enthusiasm for accepting appointment under a trust instrument that designates a trust protector that is not a fiduciary.

**1. Robert T. McLean Irrevocable Trust v. Davis, 283 S.W.3d 786 (Mo.App. S.D. 2009).** Linda McLean (“Linda”) was the Trustee of the Robert T. McLean Irrevocable Trust (the “Trust”), the governing instrument of which was dated March 31, 1999, and the mother of the Trust beneficiary, Robert McLean (“Robert”). The Trust instrument designated J. Michael Ponder to act as Trust Protector. Ponder was a lawyer who had successfully represented Robert as the plaintiff in a personal injury lawsuit. The funds awarded

to Robert from that action were used to fund the Trust, which was a special needs trust designed to supplement benefits that Robert received from various governmental assistance programs.

The Trust instrument described the role and duties of the Trust Protector as follows: “The ‘Trust Protector’ of such trust shall be [Ponder]. The Trust Protector’s authority hereunder is conferred in a fiduciary capacity and shall be so exercised, but the Trust Protector shall not be liable for any action taken in good faith.” The Trust instrument went on to state that the Trust Protector held the power to remove Trustees and to appoint successor Trustees. The Trust Protector could resign as Trust Protector and name successor Trust Protectors.

After the original Trustee resigned, Ponder appointed as successor Trustees Patrick Davis, Daniel Rau and the law firm of Patrick Davis, P.C. Davis and Patrick Davis, P.C. were originally retained by Robert to represent him in his personal injury action, but Davis later referred Robert to Ponder.

In 2000, Robert and his lawyer informed Ponder that Davis and Rau, along with Patrick Davis, P.C., were inappropriately spending trust funds. In July of 2001, Davis resigned as a Trustee. Rau and Patrick Davis, P.C. then resigned as Trustees as well. Ponder appointed Brian Menz as successor Trustee. Ponder then resigned, designating Tim Gilmore as successor Trust Protector. In July of 2002, Menz resigned as Trustee, and Linda was appointed as successor Trustee.

In April of 2005, Linda, as Trustee, filed suit against Davis, Rau and Menz as former Trustees, Ponder as the former Trust Protector and Gilmore as current Trust Protector. Linda asserted that Ponder had breached his fiduciary duties to Robert and acted in bad faith by failing to monitor and report expenditures, failing to stop the Trustees when they were acting against the interests of Robert and placing his own loyalty to the Trustees and their interests above those of Robert. Linda pointed out that Davis, Rau and Patrick Davis, P.C. had referred many lucrative clients to Ponder in the past, and Ponder shared the fees obtained from these representations with Davis, Rau and Patrick Davis, P.C.

All the defendants except Ponder settled. In the trial court, Ponder moved for summary judgment, which was granted. Linda then appealed to the Missouri Court of Appeals.

In response to Linda’s claim of breach of fiduciary duty, Ponder argued that neither Missouri law nor the Trust instrument created a duty for Ponder to monitor or supervise the Trustees. The court observed that Missouri law did not impose a duty on a trust protector. Regarding the Trust instrument, the court stated that it “does not specify how or when the Trust Protector is to carry out his ‘authority’ to remove trustees and appoint their successors.” The court relied on the definition of a “fiduciary” in Black’s Law Dictionary, which defines a “fiduciary” as “[a] person who is required to act for the benefit of another person on all matters within the scope of their relationship; one who owes to another the duties of good faith, trust confidence, and candor.” The court then pointed to the language in the Trust instrument exculpating the Trust Protector from liability for any action taken in good faith. The court found that “[t]his creation of a qualified immunity from liability for the Trust Protector for actions

taken in good faith implies the existence of at least some duty of care and that no such immunity from liability would apply for actions taken in bad faith.”

The court stated that, if the Trust Protector did owe a duty, the next issue was to whom was this duty owed. The court explained that the Trust instrument may be construed as directing that the Trust Protector owes a duty to the Trust itself to protect the Trust from mismanagement of the settlement proceeds and otherwise from Trustees that acted against the purposes of the Trust. The court concluded that “[w]hat duties and responsibilities the grantor intended the Trust Protector to have are not clearly set forth in the language of the Trust, and that intent is a significant and contested issue of material fact.” Accordingly, the court ruled that the trial court should not have granted summary judgment for Ponder and reversed and remanded the case.

On remand, the trial court found the Trust Protector’s authority was “limited to the power to remove[,]” and “under the terms of the trust agreement, the Trust Protector had no obligation to monitor the activities of the Trustee. The trial court went on to note that: (a) it was not of the opinion that the Trust Protector could simply ignore conduct of a Trustee which threatened the purposes of the trust; and (b) to the extent that any conduct took place, and to the extent that the Trust Protector was made aware of such conduct, a duty may have arisen by the Trust Protector in his fiduciary capacity to remove a Trustee.<sup>1</sup>

The most certain way to avoid the question of whether a trust protector is a fiduciary is to include appropriate language in the trust instrument, perhaps simply providing that the trust protector is a fiduciary or that the trust protector acts in a fiduciary capacity. In contrast, simply stating in the trust instrument that a trust protector is not a fiduciary or does not act in a fiduciary capacity may not be upheld if the trust protector is given any power to make decisions that directly affect beneficial interests. Trust protector compensation should also be addressed in the trust instrument. Bove, “Trust Protectors,” TRUSTS & ESTATES, Nov. 2005, at 28 (hereinafter, “Bove, Trust Protectors”).

**2. *Schwartz v. Wellin*, 90 F. Supp. 3d 579 (February 11, 2015); 2014 U.S. Dist. LEXIS 172610 (December 15, 2014); 2014 U.S. Dist. LEXIS 143644 (D.S.C. October 9, 2014); 2014 U.S. Dist. LEXIS 1528 (D.S.C. January 7, 2014).** The Wellin 2009 Irrevocable Trust (the “Trust”) held a 98.9% limited partner interest in Friendship Partners, LP (the “Partnership”). Friendship Management, LLC (“Friendship Management”) held the remaining 1.1% interest as general partner. Friendship Management ordered liquidation of the Partnership in December 2013. The proceeds from the liquidation were to be distributed to the general and limited partners on a pro rata basis.

Keith Wellin’s children comprised the Trust’s distribution committee and were also the Trustees and the Trust’s beneficiaries. The children signed written consents to the plan of

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<sup>1</sup> Upon a subsequent appeal, Ponder was absolved of any liability not because he was determined not to have had any relevant duty or not to have fulfilled any relevant duty but because the plaintiff did not show any damages that proximately resulted from Ponder’s conduct. *Robert T. McLean Irrevocable Trust v. Ponder*, 2013 WL 5761078 (2013).

distribution, which included a direction that the Trust retain enough assets to satisfy a promissory note held by Keith Wellin and distribute the remaining assets outright to themselves as beneficiaries. The Partnership assets were liquidated shortly thereafter.

The Trustees set aside \$52 million to satisfy the promissory note and distributed the remaining \$95 million to the beneficiaries. Following the distribution of the Trust assets, Lester Schwartz (“Schwartz”), as Trust Protector, filed a complaint against Keith Wellin, the children, Friendship Management and the Partnership. Schwartz alleged that the children “frustrated the intent and purposes of the Trust” by distributing assets which should have remained in the Trust for the benefit of the remainder beneficiaries.

The children moved to dismiss the case on the basis that Schwartz was not a real party in interest. To be a real party in interest, South Dakota law (which governed the interpretation of the Trust instrument) required that the person who brings the suit have a “real, actual, material, or substantial interest in the subject matter.” Citing *Ellingson v. Ammann*, 830 N.W.2d 99 (S.D. 2013). Schwartz argued that he qualified as a real party in interest because the Trust expressly authorized him to represent the Trust in litigation. The District Court denied Schwartz’ contention on the grounds that he had not personally suffered an injury as a result of the children’s conduct. Accordingly, the District Court granted the motion to dismiss.

### **III. Various Ways to Divide Duties and Responsibilities of Trust Administration**

#### **A. Drafting Trust Protector Provisions**

One of the primary drawbacks of using a trust protector is that it creates a greater administrative burden for the Trustee and consequentially increases costs. Use of a protector can also result in some delay in the Trustees exercising their powers and discretions while they await the consent of the protector. These problems can be exacerbated by poor drafting. It is imperative that the trust instrument clearly identify the administrative tasks that are to be directed and the timeframe in which such direction is to apply. Ensuring there is a clear delineation of duties can help to avoid conflicts and misunderstandings. The case of *Shelton v. Tamposi*, 62 A.3d 741 (N.H. 2013) provides a cautionary tale for those who design and administer directed trusts and shows that the trust instrument must make clear who is in charge when investment and distribution decisions are placed in different hands.

In *Shelton v. Tamposi*, the sole Trustee was in charge of distributions, and investment directors were responsible for investment and management of trust assets. The investment directors had sole authority to direct the retention or sale of all trust assets and to direct the purchase of property. The Trustee claimed she could require the investment directors to sell illiquid investments to make funds available for distributions. Affirming the lower court, the New Hampshire Supreme Court disagreed and held that the authority of the Trustee was subordinate to that of the investment directors.

Some trust instruments provide that the Trustee must submit a proposed transaction to the trust protector thereby affording the protector the opportunity to approve or veto the proposed

transaction. With regard to veto powers, the trust instrument should define when the Trustee may act if the trust protector does not respond. Typically, veto provisions allow the Trustee to act if a trust protector does not expressly veto a distribution or transaction, or if the trust protector does not respond within a specified time (e.g., 30 days) after notice to the trust protector of the proposed distribution or transaction. Another related issue is whether every single transaction carried out by the Trustee must be subject to the trust protector's veto or consent. It is usually advisable to allow the Trustee to administer the trust without such disruption and require the trust protector's approval only for significant transactions (e.g., over a specified dollar amount or regarding the sale of closely held business interests or certain other property).

Giving an independent trust protector, rather than beneficiaries, the authority to remove and replace Trustees may be desirable because such a provision can help ensure that the removal right cannot be abused. Such a power will discourage the notion that there is a so-called Trustee "revolving door," in which Trustees are influenced in their decision-making by their apprehension that any decision that is not acceptable to a beneficiary with removal powers will result in the current Trustee's dismissal. Alternatively, the requirement of some appropriate cause for removal can be strengthened by a trust provision stating, in effect, that, if the trust protector believes a proposed removal is improper, he or she may delay the removal and institute a specified dispute resolution proceeding, such as a court proceeding or arbitration.

In addition, administrative matters involving a trust protector should be considered and addressed in the trust instrument much in the same way they are considered and addressed for the Trustee. Questions of compensation and reimbursement for reasonable expenses, the employment of agents and tax counsel, indemnification and access to all trust records are issues that may be addressed. Bove, *Trust Protectors, supra*. Further, the trust instrument may provide that a trust protector may resign and how resignation is accomplished. In addition, any trust protector should be required to acknowledge his, her or its acceptance of the office in writing. The trust instrument should also contain provisions allowing the Trustee to act during any period where there is no trust protector serving, as could happen, for example, if a trust protector dies or becomes incapacitated and a successor is not quickly appointed.

A trust protector is sometimes considered when the Trustee will hold nontraditional assets, such as intellectual property, livestock, closely-held business interests, artwork, oil, gas and other minerals and certain real estate such as farm and ranch property, timberland and commercial property. The general duties of a Trustee holding nontraditional assets are presumptively similar to a Trustee's duties regarding other trust assets, but the management of these assets may require the involvement of a trust protector with specialized knowledge concerning such assets.

To ensure that the trust protector is not influenced by conflicts of interest and that the settlor, the beneficiaries and the individual trust protector avoid undesired tax and other legal consequences, the trust instrument should prohibit: (a) the trust protector from appointing as Trustee him or herself, his or her spouse, any relatives of the trust protector or any individuals in

business with the trust protector; and (b) the appointment as trust protector of the settlor, the settlor's spouse, any trust beneficiaries or any other person who has contributed property to the trust. *See* Treas. Reg. § 25.2511-1(g)(2); Rev. Rul. 95-58, 1995-2 C.B. 191. A disinterested party serving as trust protector will usually be safer and provide greater flexibility.<sup>2</sup>

Ultimately, the settlor and the practitioner should have the trust purposes in mind early in the estate planning process and attempt to anticipate reasonably the powers that would most likely assist in carrying out the trust purposes and that would be better held in the hands of someone other than the Trustee. The practitioner must be mindful, however, that some of these choices may have tax, fiduciary and/or creditor protection ramifications.

### **B. *Schwartz v. Wellin***

In another phase of this case, Wellin reserved the power to remove and replace the Trust Protector. If he could not act, Wellin vested the power to remove and replace the Trust Protector in his children. In November 2013, Schwartz amended the provision to postpone the children's ability to remove and replace the Trust Protector until the later of Wellin's death or November 20, 2018, at which time a majority of the children could request, no more than once every five years, that a committee be appointed to determine whether a Trust Protector should be removed or replaced. The amendment also set forth very specific eligibility requirements for the committee. Specifically, committee members could not be Trust beneficiaries, could not be related or subordinate to the Trust Protector as defined in IRC § 672(c), had to be Fellows of the American College of Trust and Estate Counsel and had to be members of different law firms. Wellin died on September 14, 2014.

On October 14, 2014, the children attempted to remove Schwartz and simultaneously replace him with Brian Hellman. Six days later, Hellman attempted to remove Larry McDevitt as Co-Trustee (who had been appointed by Schwartz to be the plaintiff in this action) and, another eleven days later, appoint one of Wellin's grandchildren, Keith Plum, as Trustee. The Wellin children then filed another motion to dismiss.

The children argued that Schwartz was not acting within his powers as Trust Protector when he amended the procedure for removing the Trust Protector. Specifically, the children urged that he did not have the authority to increase his power as Trust Protector, and, therefore, they properly removed him under the original removal provision. Consequently, the children concluded Hellman's subsequent actions as Trust Protector were valid. Taken as true, McDevitt would not qualify as a real party in interest, the court would not have subject matter jurisdiction, and the case would require dismissal. McDevitt asserted that the Trust Protector's amendment was valid and, because the children did not comply with the revised removal provision, McDevitt was a real party in interest.

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<sup>2</sup> For a case in which trust protectors who had strong, objective ties to the settlor and consistently acted in accordance of the settlor's wishes were essentially considered the puppets and alter egos of the settlor, see *Securities and Exchange Commission v. Wyly*, 56 F.Supp.3d 394 (S.D.N.Y. 2014).

Article VI, paragraph 3 of the Trust instrument provided that, during Wellin's life, the Trust Protector could amend the Trust instrument "with regard to how the beneficiaries will benefit from the trust, and to amend the trust administrative provisions." The plain language, according to the District Court, allowed the Trust Protector to modify "any or all powers and discretions," which included those of a Trustee, beneficiary or Trust Protector. Under this plain language, Schwartz' amendment was valid. Accordingly, the children's purported removal of Schwartz and all consequences flowing therefrom were invalid. McDevitt remained Trustee of the Trust and a real party in interest with standing to bring the suit challenging the propriety of distribution of all the Trust assets.

The District Court found revealing that, even after Schwartz's amendment, Wellin was living and retained the power to remove and replace the Trust Protector on his own. Wellin's lack of action in removing Schwartz after he amended the Trust Protector removal provision supported McDevitt's position that the amendment was valid.

#### **IV. Liability of Directed Trustees**

##### **A. State Approaches Regarding the Liability of Directed Trustees**

Some state statutes limit the liability of a directed Trustee much more comprehensively than UTC § 808. *See, e.g.*, Ind. Code § 30-4-3-9(a); S.D.C.L. §§ 55-1B-2, -5. Delaware law imposes liability on a directed Trustee only if the Trustee's action or inaction results from willful misconduct. *See, e.g.*, 12 Del. C. § 3313(b). Illinois' directed trust statute provides for three categories of "directing party" (distribution trust advisor, investment trust advisor and trust protector), affirmatively imposes fiduciary duties on these directing parties and generally absolves the directed Trustee from liability for carrying out a director's instructions. 760 ILCS 5/16.3. The law of Virginia (Code of Virginia § 64.2-1416(D)) generally absolves an excluded fiduciary from liability (except, possibly, as a ministerial agent) for investment losses resulting from following an authorized direction. In Missouri, a directed Trustee isn't liable for any loss resulting from acts or omissions validly directed by the trust protector (or as a result of the trust protector's failure to provide consent) except in cases of the Trustee's bad faith or reckless indifference or as otherwise provided in the trust instrument. Mo. Rev. Stat. § 456.8-808.

It would therefore seem that the practical ability of a directed trust beneficiary to recover damages for the trust may be elusive. Directed Trustees should not conclude, however, that they are off the hook in all states and in all circumstances. As demonstrated above, directed trust statutes vary considerably in terms of the circumstances in and extent to which they confer protection from liability on Trustees.

##### **B. Case Law Regarding Directed Trustees**

Trustee liability in the context of directed trusts is based in part on the extent to which a directed Trustee may or must follow directions from a third party. Liability may also arise from the inaction of a directed Trustee if that Trustee slavishly implements an improvident direction.

In *Duemler v. Wilmington Trust Company*, 2004 Del. Ch. LEXIS 206 (2004), the investment director, R. Leigh Duemler, sued Wilmington Trust Company, the directed Trustee, claiming that it had breached its fiduciary duty by not providing him with timely financial information that would have allowed him to make a recommendation and avoid investment loss. The trust company defended itself relying on the Delaware directed trust statute (12 Del. C. § 3313), which provides, in pertinent part:

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.

In an unpublished order, the court exonerated the Trustee, finding it had engaged in no willful misconduct.

*Rollins v. Branch Banking & Trust Co. of Virginia*, 56 Va. Cir. 147 (2001), also involves the duties of a directed Trustee. The trust instrument vested the power to retain, sell or purchase investments exclusively in the beneficiaries. The Trustee sold the stock twenty years later at the direction of the beneficiaries for a fraction of its original value.

The beneficiaries sued, claiming that the Trustee failed to diversify and failed to warn the beneficiaries of the declining condition of the trust investments. As to the first claim, the court found that the Trustee could not be liable for a failure to diversify trust investments under Va. Code § 26-5.2 (predecessor to Va. Code § 64.2-1416), which provided that, when a trust instrument reserves investment authority in an advisor or similar party to the exclusion of a Trustee, “the excluded fiduciary or co-fiduciary shall be liable, if at all, only as a ministerial agent and shall not be liable as fiduciary or co-fiduciary for any loss resulting from the making or retention of any investment pursuant to such authorized direction.” As to the second claim, however, the court opined that the statute “does not excuse a trustee from liability for failing to participate in the administration of the trust or for failing to attempt to prevent a breach of trust.” Prior to a final resolution on the merits of the latter claim, the beneficiaries settled with the Trustee.

In *In re Helen Rivas Trust*, 2011 NY Slip Op 50008U, 30 Misc. 3d 1207(A) (Monroe County Surr. Ct. 2011), the trust in question was held for the benefit of the University of Rochester in Rochester, New York (the “University”). The trust instrument established an investment advisory committee (the “Advisory Committee”) of three individuals, two named by the University and one named by the Trustee. The Advisory Committee had all powers over the management of investments.

In 2009, the Advisory Committee directed the investment of all trust assets in the University’s long-term investment pool (“LTIP”). The Trustee sought an interpretation of the trust instrument by a court to determine whether the investment in the LTIP was proper. In its holding, among other things, the court refused to give effect to the trust provision purporting to



absolve the Trustee from responsibility regarding investments and found that the investment of trust assets in the LTIP essentially was an impermissible delegation of investment duties.

In *Mennen v. Wilmington Trust Company*, C.A. No. 8432-ML; 2015 Del Ch. LEXIS 122 (April 24, 2015), the trust instrument conferred the power to retain, sell or purchase investments exclusively on the trust beneficiaries. The beneficiaries directed the Trustee to hold an over-concentrated position in certain stocks. Twenty years later, at the direction of the beneficiaries, the Trustee sold the stock for a fraction of its original value. The beneficiaries sued for \$25 million, claiming the Trustee failed to diversify and failed to warn the beneficiaries of the declining value of the stock.

The trial court noted: “Because the trust agreement modified the trustees’ default duties and exculpated the trustees from liability unless they acted in bad faith or with wilful misconduct, a showing that the trustees committed a lesser breach of trust will not result in the judgment the beneficiaries seek.” Ultimately, the corporate Trustee settled out of court, so whether the Trustee’s reliance on the beneficiaries’ direction was appropriate was not determined on appeal.



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