

By **R. Hugh Magill**

# Allocating Fiduciary Responsibility

Sole, shared ... or split?

I DO PERCEIVE HERE A DIVIDED DUTY.  
*William Shakespeare, Othello: Act 1, Scene 3*

**T**he estate-planning process presents clients with myriad weighty issues relating to the disposition of their assets: Who should receive their assets; What assets should each receive; When should assets be transferred (during life or at death); How should they be held (outright or in trust); and Which trustee should manage assets and care for one's beneficiaries (for dispositions held in trust)? U.S. clients have always enjoyed significant latitude in resolving these issues, owing to what's been called the "organizing principle of the law of succession"<sup>1</sup>—freedom of disposition. This concept remains firmly entrenched in both the law and practice of estate planning and affords clients significant flexibility in resolving the above issues. Testamentary freedom, though, has been subject to certain public policy limitations (the rights of creditors and surviving spouses, for example), fiscal constraints (federal and state transfer taxes) and legal conventions, such as those governing fiduciary responsibility. Only recently has trust law afforded grantors significant freedom in the allocation of fiduciary responsibility for dispositions held in trust.

The practice of reassigning various responsibilities in the administration and management of a trust, among a trustee and other advisors,<sup>2</sup> results in what's often called a "directed trust" or "divided trusteeship."

Thoughtful allocation of fiduciary responsibility can accommodate a wide range of circumstances. Its effectiveness in fulfilling grantor intent and providing for beneficiaries' best interests will rest on careful planning and drafting, proactive communications among advisors and trustees and an understanding by trustees and advisors that their responsibilities must be fulfilled in "scrupulous good faith and candor."<sup>3</sup>

## Allocation of Responsibilities

A trust requires three essential elements: (1) one or more beneficiaries, (2) trust property, and (3) a trustee "who holds title to the

property" and "is subject to duties to deal with it for the benefit of one or more others."<sup>4</sup> The common law has traditionally contemplated that the trustee (or trustees) in title to the trust property would fulfill all fiduciary responsibilities to the trust beneficiaries. Creative grantors, however, have long exercised the freedom to allocate fiduciary responsibility among the trustee and other advisors (usually individuals, sometimes in committees). These non-trustee advisors have commonly been given fiduciary responsibility for some discrete trust activity, typically encompassing asset management<sup>5</sup> or discretionary authority for trust distributions.

While the common law traditionally forbade delegation of substantive fiduciary responsibilities,<sup>6</sup> these changes in trust responsibility weren't delegations by trustees; rather, they were reallocations of fiduciary responsibility by grantors themselves. The ability to subject the trustee to the direction of another party was recognized as early as 1959 in the *Restatement (Second) of Trusts* Section 185, which provided:

If under the terms of a trust a person has power to control the action of the trustee in certain respects, the trustee is under a duty to act in accordance with the exercise of such power, unless the attempted exercise of the power violates the terms of the trust or is a violation of a fiduciary duty to which such person is subject in the exercise of the power.

## Directed Trusts

Directed trusts didn't receive statutory recognition until 1986, when the Delaware General Assembly enacted the nation's first private, directed trust statute.<sup>7</sup> Forty-two states and the District of Columbia have since followed suit, including those that have adopted the Uniform Trust Code (UTC) and its Section 808, Powers to Direct.<sup>8</sup> Directed trusts, and the statutes that sanction them, present clients with significant latitude in the assignment of fiduciary responsibility for various elements of trust administration and management. These elements may be divided among four general categories: (1) custody of trust assets; (2) administration of the trust; (3) management of trust assets; and (4) authority over distributions. Directed trusts have generally reallocated fiduciary duties in the last two categories.

## Grantors' Motives

Grantors' motives for reallocating fiduciary responsibility vary. For those naming an advisor for asset management, common themes



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include management of a unique asset (for example, a closely held business or real estate holding), retention of a trusted, lifetime investment advisor (who's unqualified or unwilling to serve as trustee) and oversight of limited market assets integrated with leveraged estate-planning strategies (such as limited liability companies, limited partnerships and private installment notes). Advisors granted authority for discretionary distributions are often chosen for their personal relationship with beneficiaries, particularly when a beneficiary has special needs. Some grantors select advisors who are staff members of their family offices, to use their expertise and coordinate their responsibilities among similarly situated trusts. While thoughtfully drafted directed trusts typically designate these advisors as fiduciaries, and usually relieve the trustee of responsibility to monitor or intervene with the advisor's actions, directed trusts, with their intrinsic separation of fiduciary duties, require careful consideration and drafting.

### Degree of Oversight

One of the most important issues to be addressed in the design of a directed trust is the degree of oversight that the trustee is to exercise in regard to the directions of advisors. The most conservative approach is that promulgated by the *Restatement (Second) of Trusts* Section 185,<sup>9</sup> quoted above.

The UTC contemplates a slightly less intrusive, although inherently judgmental, role for the trustee in relation to the advisor. UTC Section 808(b) provides:

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<sup>10</sup> (emphasis added).

Twenty-two states have adopted statutes that provide for very limited or no oversight of advisors' actions by trustees. The Delaware statute, for example, states:

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.<sup>11</sup>

It should be noted that there are very significant differences among the states in the latter category. Some limit advisory roles to investment management (Colorado, Georgia, Oklahoma and Utah), and several impose different standards for the directed trustee's liability, such as "bad faith or reckless indifference" (Arizona, Georgia, and Missouri). Eight states have no directed trust statute. (See "Directed Trust Statutes,"

p. 3, for a summary of state laws.)

Grantors are, of course, free to structure the relationship between the trustee and an advisor as they wish. The UTC recognizes this freedom in its comments to Section 808:

The provisions of this section may be altered in the terms of the trust. A settlor can provide that the trustee must accept the decision of the power holder without question.

### Court Decisions

While the trends in trust design and trust statutes seem to indicate increasing deference to the decisions and direction of advisors, what's much less clear is the extent to which courts will respect trustees' limited roles when advisors' decisions result in losses to a trust and harm to its beneficiaries. There are very few reported cases on this issue.

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Delaware's directed trust statute was unequivocally upheld in an unreported 2004 case, *Duemler v. Wilmington Trust Co.*,<sup>12</sup> in which the plaintiff (who served as an investment advisor and was a remainder beneficiary) sued the trustee over losses resulting from her decision not to tender securities in an exchange offer. The court found for the trustee in observing:

Section 3313(b) of title 12 of the Delaware Code insulates fiduciaries of a Delaware trust from liability associated with any loss to the trust where a governing instrument provides that the fiduciary is to follow the direction of an advisor, the fiduciary acts in accordance with such direction, and the fiduciary did not engage in willful misconduct.

Virginia's statute on excluded fiduciaries (which appears to have been eclipsed when Virginia adopted the UTC) was similarly upheld in *Rollins v. Branch Banking and Trust Co. of Virginia*,<sup>13</sup> in which the court observed that it "cannot hold a trustee, or anyone else, liable for decisions that it did not and could not have made."<sup>14</sup>

*Shelton v. Tamposi*<sup>15</sup> involved an "excluded fiduciary" under New Hampshire's directed trust statute.<sup>16</sup> The court found that while two sons named as investment directors held responsibilities that "were more commonly held by trustees ..., the authority of the trustee is subordinate to that of the investment directors."<sup>17</sup>

### Uniform Law Commission

The lack of uniformity among the states has led to interesting statutory proposals on divided trusteeship<sup>18</sup> and precipitated the formation of a Drafting Committee for an Act on Divided Trusteeship

## Directed Trust Statutes

*A jurisdiction-by-jurisdiction breakdown*

Alabama	Ala. Code §19-3B-808	Montana	Mont. Code Ann. §72-38-808
Alaska	Alaska §13.36.375	Nebraska	Neb. Rev. Stat. §30-3873
Arizona	Ariz. Rev. Stat. Title 14, Art. 8-10808.B	Nevada	Nev. Rev. Stat. §163-533
Arkansas	Ark. Code §28-73-808(b)	New Hampshire	New Hamp. Rev. Stat. §564-B: 8-808
California	N.A.	New Jersey	N.A.
Colorado	Colo. Rev. Stat. § 15-1-307	New Mexico	New Mex. Stat. §46A-8-808
Connecticut	N.A.	New York	N.A.
Delaware	Title 12 Del. Laws C.33, §3313	North Carolina	N. Car. Gen. Stat. §36C-7-703 (e) [Co-trustees], §36C-8A-4 [Power holders]
Florida	Fla. Stat. §736.0808	North Dakota	N. D. Cent. Code §59-16-08
Georgia	O. C. G. A. §53-12-303 (c)	Ohio	Ohio Rev. Code §5808.08
Hawaii	N.A.	Oklahoma	Okla. Code §60-175.19
Idaho	Id. Stat. §15-7-501	Oregon	Or. Rev. Stat. §130.685
Illinois	760 ILCS 5/16.3	Pennsylvania	Penn. Con. Stat. Title 20 §7778
Indiana	In. Code §30-4-3-9 (b)	Rhode Island	N.A.
Iowa	Iowa Trust Code §633A. 4207	South Carolina	S.C. Code §62-7-808
Kansas	Kansas Stat. Ann. §58a-808	South Dakota	S.D. Cod. Laws §55-1B
Kentucky	Ky. Rev. Stat. Ch. 386B. 8-080	Tennessee	Tenn. Code §35-15-808
Louisiana	N.A.	Texas	Tex. Prob. Code Ann. §114.003
Maine	Maine Rev. Stat §18-B-808	Utah	Utah Code §75-7-906
Maryland	Maryland Trust Act §14.5-808 (effective 1/1/15)	Vermont	Ver. Stat. Ann. Title 14A §808
Massachusetts	Mass. Gen. Laws Ch. 203E, Art. 8-808	Virginia	Va. Code §64.2-770
Michigan	Mich. Comp. Laws §700.7809	Washington	N.A.
Minnesota	Minn. Stat. Ch. 501C.0808 (effective 1/1/16)	Washington, D.C.	D. C. Code §19-1308.08
Mississippi	Miss. Code §91-8-808	West Virginia	W. Va. Trust Code §44D-8-808
Missouri	Missouri Rev. Stat. §456.8-808	Wisconsin	Wis. Stats. §701.0808
		Wyoming	Wyom. Stat. §4-10-808, §4-10-715

— R. Hugh Magill

under the Uniform Law Commission, led by Professor Robert H. Sitkoff of Harvard Law School and attorney and American College of Trust and Estate Counsel Fellow, Turney P. Berry of Louisville, Ky.<sup>19</sup>

The Study Committee for this undertaking has stated as one of its policy goals that:

. . . the settlor would have broad autonomy in structuring the trust but the law would insist that there be at all times a decision maker who owes fiduciary obligation to the beneficiaries with respect to any decision affecting the custody, administration, investment or distribution of the trust property.

As noted above, the common and traditional statutory law of trusts contemplated a trust with a single trustee or co-trustees<sup>20</sup> who were charged with comprehensive responsibilities for the administration and management of the trust, as depicted in “Traditional Trust,” p. 4. In some directed trusts, grantors bifurcate asset management responsibility (which is assigned to an advisor) while reserving the balance of fiduciary responsibilities to the trustee, as shown in “Directed Trust,” p. 4. Creativity in trust design, facilitated in part by the rapid promulgation of directed trust statutes, has led to more complex fiduciary arrangements, either assigning fiduciary responsibilities among various advisors, as shown in “Multiple Advisor Trust,” p. 5, or among advisors and trustees with discrete roles, as depicted in “Divided Trusteeship,” p. 5. These more complex trusts present unique



challenges around communication, collaboration and coordination among the advisors and trustee(s).

### Design and Drafting

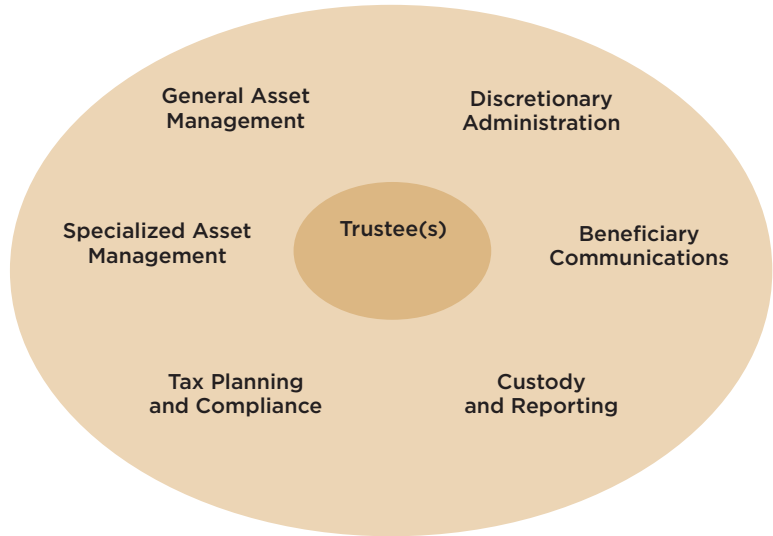
Thoughtful design and drafting of a directed trust should involve consideration of the following issues, to reflect grantor intent, its consistency with the law of the jurisdiction that will govern the validity, interpretation and administration of the trust, as well as the consent of trustees and advisors to fulfill the responsibilities expected of them under the trust agreement:

1. Scope of and terms clarifying each advisor's and trustee's responsibilities and powers (subject to limitations imposed, if any, under state law).
2. Degree of oversight to be exercised by the primary/directed trustee in regard to advisors' directions (implementation alone or assessment for consistency with trust terms and fiduciary duty).
3. Nature of the advisor's power: fiduciary or personal. Under most state statutes, advisors are deemed to be fiduciaries unless the governing instrument designates to the contrary. It's likely (in my opinion) that a trust that allocates a substantive trust responsibility (relating to custody, administration, management or distributions) to an advisor who isn't designated a fiduciary, may be found to be invalid to that extent, or its advisor may be held to be a fiduciary retroactively.
4. The standard of care applicable to the advisor's actions.
5. Communications among the advisors and trustee and disclosure of information necessary for the fulfillment of each fiduciary's own responsibilities.
6. Mode of decisionmaking, when fiduciary responsibilities are shared.
7. Acceptance, declination, resignation and removal.
8. Vacancy, succession and substitution (when an advisor is unable to act).
9. Compensation.

See "Sample Trust Provision," p. 6, for an example of how a trust might appoint a manager for special assets.

## Traditional Trust

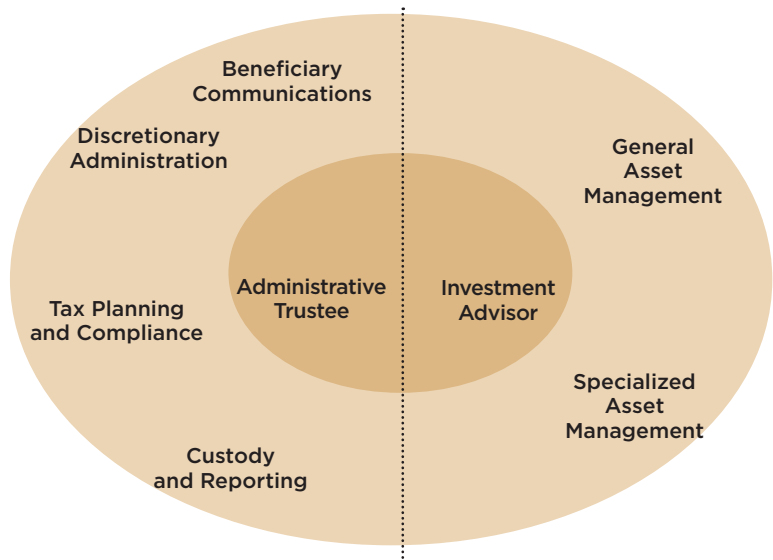
*The trustee fulfills all the fiduciary responsibilities*



— R. Hugh Magill

## Directed Trust

*Asset management responsibilities are assigned to an investment advisor while the administrative trustee fulfills all other fiduciary duties*




— R. Hugh Magill

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## A Brave New World

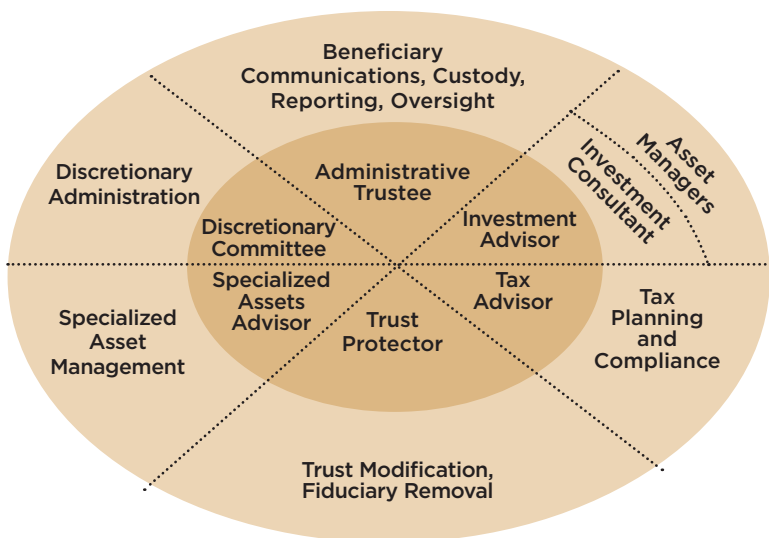
The proliferation of directed trusts represents a new fiduciary paradigm where expansion of the principle of freedom of disposition is leading to dramatic re-allocation and, some would say, dispersion, of fiduciary responsibility. Outside the few states with reported cases, there's little guidance on how the judiciary will view the restructuring of fiduciary responsibilities, statutorily sanctioned though it may be. While many, if not most, directed trusts will both fulfill grantor intent and serve the best interests of their beneficiaries, those that don't face an uncertain future. Thoughtful trust design and careful selection of and coordination among the trustee and advisors will lay the best foundation for successful trust administration and management. 

## Endnotes

1. Robert H. Sitkoff, "Trusts and Estates: Implementing Freedom of Disposition," 58 *St. Louis U. L. J.* 643 (2014).
2. I'll refer to "advisors" throughout this article in accordance with the conventions recommended by Kathleen R. Sherby in her presentation at the 2015 Heckerling Institute on Estate Planning: "In Protectors We Trust: The Nature and Effective Use of 'Trust Protectors' as Third Party Decision Makers."
3. *Black's Law Dictionary* defining "fiduciary."
4. *Restatement (Third) of Trusts* Section 2, Comment f.
5. See, e.g., Northern Trust Form 201, Section 20.
6. *Restatement (Second) of Trusts* Section 171.
7. Originally Del. Code, 65 Laws 1986, Ch. 422 Section 5. Presently 12 Del. Code Section 3313. Institutional trustees of retirement trusts established under the Employee Retirement Income Security Act (ERISA) received statutory imprimatur for directed trust structures on ERISA's enactment in 1974. Prior to its adoption of the Uniform Trust Code (UTC), Virginia had a statute (Va. Code Section 26.2.C) that insulated excluded fiduciaries from liability for following an advisor's investment directions.
8. Thirty states and the District of Columbia have enacted the UTC.
9. Two states have adopted this approach: Indiana and Iowa.
10. All states that have adopted the UTC have included Section 808, either in its entirety or with modifications.
11. Del. Code Ann. Title 12, Section 3313(c). Under Delaware law, a directed fiduciary has no duty to monitor the advisor's conduct, provide advice to the advisor or warn or apprise any beneficiary.
12. *Duermier v. Wilmington Trust Co.*, C.A. 20033 V.C. Strine (Del.Ch. 2004).
13. *Rollins v. Branch Banking and Trust Co. of Virginia*, 56 Va. Cir. 147 (2001).
14. *Ibid.*, at 149.

## Multiple Advisor Trust

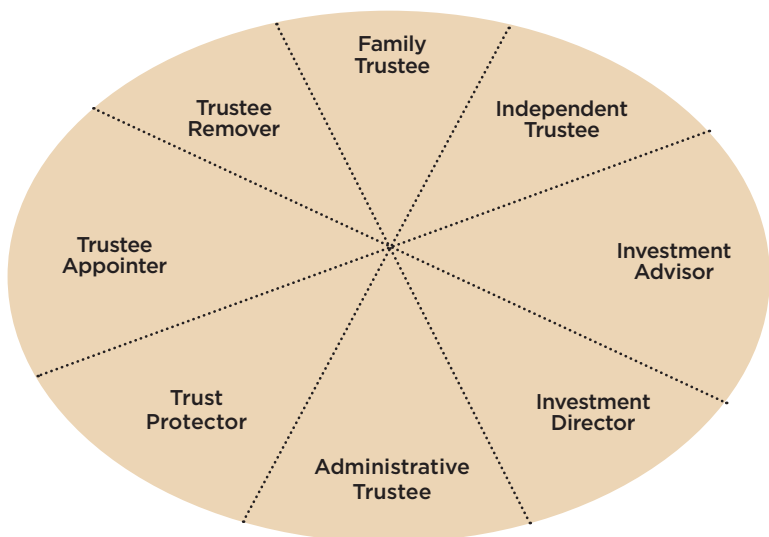
*Each fiduciary has a specific role*



— R. Hugh Magill

## Divided Trusteeship

*Fiduciary responsibilities are allocated among advisors, directors and trustees, each with a discrete role*



— R. Hugh Magill



## Sample Trust Provision

### *Appointing a manager for special assets*

If non-marketable assets (for example, partnership interests, closely held stock, real estate, loans) or investment concentrations of marketable securities may be included in a trust, this should be discussed in advance with the corporate trustee. If these assets are to be retained, clients usually want to relieve the corporate trustee of investment responsibility for them. If this is desired, add to the end of SEVENTH:

36 SECTION 20: A trust under this agreement may hold some or all of the following assets, which shall be known as "special assets:"

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Notwithstanding the general investment powers of the trustee, the following provisions shall apply to the special assets in the trust:

(a) I appoint the following individuals who are willing and able to act (singly, and in the order listed) to act as manager for the special assets in the trust:

- (i) Myself
- (ii) The remaining individual cotrustees or cotrustee of the trust (if any)
- (iii) \_\_\_\_\_
- (iv) \_\_\_\_\_

(b) While a manager is acting, the manager shall have sole investment, voting and management responsibility (and the trustee shall have no such responsibility) for the special assets in the trust. The trustee shall sell the special assets, and deal with them, only upon the written direction of the manager. The trustee shall be under no obligation to review the special assets, make any investment recommendation with respect to them, solicit any direction from the manager, or value special assets which are non-marketable. The trustee need not review whether the manager is satisfying his or her responsibilities hereunder, and the trustee shall not be liable for any action or inaction of the manager.

(c) The powers of the manager (other than myself) shall be deemed to be and exercised as fiduciary powers. Special assets may include stock or other interests in a corporation, partnership, limited liability company or other entity (herein called a "company"). The manager's fiduciary powers shall not preclude the manager from holding office in a company, accepting remuneration from it, voting any interest in favor of himself or herself as director, manager or officer, or purchasing or selling interests in the company. The trustee shall make tax elections with respect to a company only as the manager directs. If a firm succeeds to part or all of the business or assets of a company by merger, consolidation, reorganization or otherwise, the trust's interest in that firm (whether or not publicly traded) shall continue to be a special asset of the trust.

(d) Special assets may include interests in real estate. The trustee shall have no responsibility, other than title holding, for those interests and the tangible personal property associated with them. The manager shall have sole responsibility for managing, insuring, leasing and repairing the properties, collecting rents, and paying all taxes and expenses on the properties. The trustee shall deal with the properties only as and when directed to do so by the manager. If the manager asks the trustee to provide additional money for the expenses or improvement of a special asset, however, the trustee shall have responsibility for determining whether or not to provide funds. The manager may employ property managers at the expense of the trust or may manage the properties personally. The trustee need not review or inspect the properties, except that the trustee shall have the right (but not the duty) to exercise the trustee's environmental powers under this agreement.

(e) A manager shall be entitled to reasonable compensation, unless waived, and to reimbursement for reasonable expenses, including travel costs.

(f) The statement of the trustee that it is acting according to this section shall fully protect all persons dealing with the trustee. The trustee shall have no responsibility for any loss that may result from acting in accordance with this section.

15. *Shelton v. Tamposi*, 62 A.3d 741 (N.H. 2013).

16. N. H. Rev. Stat. Ann. Section 564-8-808 (b).

17. *Shelton*, *supra* note 15 at 747.

18. Note for example, James P. Spica, "Onus Fiduciae Est Omnis Divisa In Partes Tres: A Statutory Proposal for Partitioning Trusteeship," 49 *Real Property, Trust and Estate Law Journal* 2, 349 (2014).

19. The author serves as an Observer to this Committee.

20. Each co-trustee has a duty at common law (see *Restatement (Third) of Trusts* Section 81) to actively participate in the administration and management of the trust.

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