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Subject: James M. Kane - A (Very) Useful Primer on "Directed Trusts"

"Georgia was the first state to adopt the Uniform Directed Trust Act ('UDTA'), effective July 1, 2018. Although directed trusts have been around for a number of years, the UDTA is indicative of the increased attention, interest and use of a directed trust. As noted below, the UDTA widens the door of opportunity for implementing directed trusts and provides a better framework for including directed trust provisions in a trust document. This commentary will give readers a good, foundational overview of directed trusts and how they can benefit one's trust planning."

We close the week with commentary by **James M. Kane** that provides a useful primer on directed trusts, which are getting much more attention in view of states beginning to adopt the Uniform Directed Trust Act ("UDTA"). Members will find his commentary particularly helpful as it contains sample directed trust language.

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James is licensed in Georgia, North Carolina, and New York. He has 20+ years' experience previously with Atlanta law firms Sutherland, Asbill & Brennan and Chamberlain, Hrdlicka, White, Williams & Aughtry. James

attended Emory University Law School and also has undergraduate finance (University of Georgia) and graduate business (Georgia State University) degrees. Although he never worked as a CPA, James held a CPA certificate during his time with the IRS. James was the winner of the 2016 Heckerling Tax Court Brief writing contest. James' outside interests include studying jazz guitar. Google also: James Kane Legal Blog

Here is his commentary:

EXECUTIVE SUMMARY:

Georgia was the first state to adopt the Uniform Directed Trust Act ("UDTA"), effective July 1, 2018. Although directed trusts have been around for a number of years, the UDTA is indicative of the increased attention, interest and use of a directed trust. As noted below, the UDTA widens the door of opportunity for implementing directed trusts and provides a better framework for including directed trust provisions in a trust document. This commentary will give readers a good, foundational overview of directed trusts and how they can benefit one's trust planning.

COMMENT:

There already is an abundance of website posts and articles about directed trusts that, in my view, are well written, comprehensive, and complex; but not boiled down sufficiently to give readers a useful, introductory framework of a directed trust and the gist as to why anyone should care or give much attention to directed trusts. For the reasons I state below, I see this evolution of directed trusts as a significant and powerfully beneficial trust law development.

I am particularly interested in directed trusts, as my home state Georgia was the first state in the nation to enact sweeping UDTA trust law changes, with these changes effective July 1, 2018. These new laws are in Georgia O.C.G.A. Sections 53-12-500 thru 506. UDTA is a reference to the "Uniform Directed Trust Act".

What, As a Practical Matter, Does "Directed Trust" Mean?

The 60-second answer to this question is that a directed trust allows a "trust director" (more on this term below) to *direct* others to serve as one or

more trustees of the trust – with each such trustee thereafter being a "directed trustee". One or more directed trustees, as designated by the trust director, will then handle certain aspects of the operation of the trust. For example, the trust director can direct an investment trustee to handle the investment management of the trust assets. Or, as another example, the trust director can direct an administrative trustee to handle the administration of the trust. This team approach using other directed trustees enables the trust director to carve up these trust responsibilities, sometimes referred to as *à la carte* trust administration.

This next point is crucial for understanding a directed trust. That is, someone recently said to me "But, don't' trustees already have the power to delegate various functions for a trust without the need for this directed trust legislation?". I replied, "Yes, in general terms." However, my response was (and is) that when a trustee delegates certain functions of a trust to others, such as to an investment advisor, or for the administration of the trust, the existing law (including case law) is not consistent or clear as to who has liability under a delegation situation.

More specifically, when a trustee delegates a trust function to someone else (or even mistakenly believes there has been a proper delegation), as a general rule, the trustee who makes the delegation remains on the hook as to any liability, problems, or deficiencies caused by the person or entity who took on the delegation. The beneficiaries can still point the finger directly at the trustee, even though the trustee may try and argue the malfeasance was caused solely by the person of entity handling the delegated function.

See, for example, Mennen v. Wilmington Trust Co., 2015 Del. Ch. LEXIS 122 (February 13, 2015), in which the corporate trustee (Wilmington Trust) asserted the 1970 trust at issue involving a substantial investment loss was a directed trust, thus requiring that the corporate trustee follow the direction of the individual trustee (who was a son of the settlor, and who, arguably, was a directed trustee for the trust investments). The trust beneficiaries asserted, to the contrary, that the trust document did not authorize nor reflect any intent for a directed trustee as to the investments. However, this directed trust question was never fully answered in the litigation as the corporate trustee settled with the beneficiaries on the eve of trial. *Id.* at 61.

Longstanding case law (typically applying common law) also is not consistently clear on whether the delegated person or entity owes a duty to

the trust beneficiaries, or whether that person or entity is merely acting as an agent for the trustee and owes a duty only to the trustee; again, with all beneficiary fingers pointing likely only to the trustee who made the delegation. I purposely do not get into the weeds on this historical case law, but make the point that the directed trust statutes greatly help clarify this thicket.

The Powerful (and Practical) Benefit of a Directed Trust

Many clients will name a spouse or family member as trustee or co-trustee. This is fairly typical, especially for clients not in the upper 1-percent level of wealth. I have no general objection to spouses and other family members serving as trustees. But, on the other hand, I have always recognized the inevitable tension that exists for many families on the question of who will be the trustees and the liability for those trustees.

For example, if Dad is the trustee of Mom's trust, not only does Dad take on a great deal of responsibility for the administration and operation of the trust, he is, as a general rule, liable to the trust beneficiaries, even if he delegates certain trust responsibilities to others (in line with my discussion above). Sure, Dad can point his finger at the person or entity who handled the delegation, but the beneficiaries' fingers will likely still also be pointed directly at Dad.

By contrast, in a directed trust situation (and if Dad is named in a directed trust document as a "trust director" separate from his capacity as trustee; more on this below), Dad is not entirely off the hook after he, as trust director, directs another trustee to handle a trust function (such as directing a trustee to handle the investment management). But, Dad is able to spread the risk and liability.

Under Georgia's adoption of the UDTA, Dad, as a "trust director", has the same fiduciary duty and liability in the exercise or non-exercise of his power of direction "as a trust in a like position and under similar circumstances." O.C.G.A. §53-12-503(a)(1). Thus, Dad as a trust director – consistent with the fiduciary duty of a trustee – in all cases will still have a duty to administer the trust, including his selection of directed trustees, diligently and in good faith, in accordance with the terms of the trust and applicable law. *See Hasty v. Castleberry*, 293 Ga. 727, 733, 749 S.E.2d 676 (2013).

Now, here is the kicker as to a substantial benefit of using a directed trust. A directed trustee is a trustee with a fiduciary duty to the beneficiaries and with direct liability to the beneficiaries. The directed trustee is not merely an agent for the trustee. Furthermore, arguably my above discussion about whether the beneficiaries can point the finger directly at an agent of the trustee falls by the wayside. They can point to the directed trustee. As I again state below, there is great value to making sure anyone who assists with the management and operation of a trust is subject to a fiduciary standard and answerable to the trust beneficiaries.

Can Dad Be Designated Both as a "Trustee" and "Trust Director"

The "Dad" discussion above raises the question about whether Dad can be named as both a trustee and trust director. I don't know the answer, yet. The 2018 Georgia law on directed trusts is still in its infancy. But, my reading of the following Georgia UDTA mandate that appears to prevent a trustee – while *serving* as trustee -- from exercising his or her trustee powers for the purpose of naming another directed trustee leaves unanswered the question as to whether Dad can simultaneously wear two separate hats as both a trustee and a trust director under the terms of Mom's trust document.

The Georgia UDTA provides:

> Trust director means a person that is granted a power of direction by a trust to the extent the power is exercisable <u>while the person is not serving as a trustee</u>, regardless of how the trust instrument refers to such person and regardless of whether the person or settlor of the trust.
>
> O.C.G.A.§ 53-12-500(4) [underlining added].

I do not know how the above "while . . . not <u>serving</u> as trustee" fits with a situation where a person is named as both the trustee and the trust director. As a practical matter, and while the above question remains open, I would still make Dad both a trustee and trust director so that Dad can be in a position to put directed trustees in place, if and when necessary. The trust document can also include other provisions for the naming and designation of successor trust directors (such as giving a Trust Protector a non-fiduciary power as trust

director; or naming other family members or trusted individuals as trust directors, etc.).

I Highly Recommend Adding "Gross Negligence" Along with the "Willful Misconduct" Standard

I see a trend among many states for inclusion only of a "willful misconduct" statutory standard for a directed trustee's liability. *See, for example*, the recent Georgia directed trust provisions under O.C.G.A. § 53-12-504(a), (c) and (e)(1)D).This statutory scheme shields a directed trustee from liability for gross negligence. Georgia case law defines "willful misconduct" as an actual intention to do harm or inflict injury. By contrast, the case law defines "gross negligence" as the failure to exercise that "degree of care that every man of common sense, however inattentive he may be, exercises under the same or similar circumstances; or lack of the diligence that even careless men are accustomed to exercise." *Currid v. DeKalb State Court Prob. Dep't*, 274 Ga. App. 704, 707, 618 S.E.2d 621 (2005).

There are two substantive problems with limiting a directed trustee's liability only to willful misconduct. One is that the high "willful" standard eliminates potential claims against trustees who are simply not – and without specific intent -- that smart, not good at what they do, sloppy, or careless. Two is that the litigation burden of proof is on the plaintiff (a trust beneficiary) to prove the element of willful intent under a willful misconduct standard. This is a mile-high standard, when on a broader scale in many cases I believe fiduciary liability is quite often the result of unintended ignorance or simply an absence of a fire-in-the-belly desire to perform stellar, top-quality work. No proof of intent is required.

Accordingly, in the trust document as to all references to trustee liability (including directed trustees), I recommend expanding the directed trustees' liability to include both gross negligence and willful misconduct.

Directed Trusts Can Significantly Enhance the Investment Management for a Trust

Two points here:

One. Elder financial abuse is skyrocketing. For this reason, I strongly recommend families *presently* develop a relationship with a trusted, competent investment advisor who can help oversee the family's investment assets. And, as needed, that trusted investment advisor can be, *or later become*, the family's directed investment trustee, consistent with sufficient language in the trust document allowing for directed trustees.

This advisory oversight, coupled with the above fiduciary duty standard and the now-stricter FINRA rules that address the financial exploitation of seniors, helps provide another team-member set of eyes and ears alert to the threat of financial abuse and fraud, etc. [FINRA is the self-regulated Financial Industry Regulatory Authority, Inc.]

Two. Using a directed trustee set-up will mandate that the trust investment advisor must act under a fiduciary-duty standard. Otherwise, not all investment advisors are subject to a fiduciary standard; some are subject only to a lower "suitability standard". Non-fiduciaries are not under a legal duty to act in the best interest of a client and can act in their own best interest without penalty. By contrast, any trustee, including a directed trustee, who acts on behalf of a trust must act in a fiduciary capacity.

This means an investment advisor who accepts the role of a directed trustee must act in a fiduciary capacity (coupled with both the gross negligence and willful misconduct standards I recommend above). The directed trustee language in the trust document can also require a directed trustee (e.g., investment advisor) to put in writing the terms of the directed responsibility and to state expressly that he or she will act under a fiduciary duty.

The Trust Document Must Expressly Indicate the Settlor's Intent for Directed Trustees

The Georgia UDTA states that "a trust instrument may grant powers of direction to a trust director". O.C.G.A. § 53-12-502(a). In my view, this means a trustee acting under trust document that is silent on the notion of directed trustees cannot designate directed trustees and cannot rely on the provisions of the Georgia UDTA.

In addition, these new UDTA provisions appear well-drafted, and comprehensive. But, easy, quick, no-thought, simple reliance on

uniform laws can blind the lawyer drafting the trust. Even with these progressive laws, there needs to be artful trust document drafting so as to take advantage of these directed trust provisions, but without leaving unintended gaps or ambiguities in the trust document that cause problems down the road. Of course, artful drafting has always been the case with virtually any trust document.

Inclusion of the UDTA in a Trust Document

The UDTA now gives estate and trust planners the ability to incorporate by reference, include, and rely, on the framework of the UDTA provisions in a trust document. Although the various drafting considerations for a UDTA trust are beyond the scope of this newsletter, I offer three points for the reader's consideration.

One is my opinion that a trust document that does not include language sufficient to reflect the settlor's intent for using directed trustees will not benefit from these UDTA provisions. More broadly, I do not believe there can be any use of directed trustees (regardless of the UDTA) in the absence of authority under the governing document.

Two, and as to older trust documents that do not reflect the intent to use directed trustees, there *may be* a possibility of decanting the older trust into a new trust that does include directed trust provisions. But, at least under the Georgia UDTA, I am not sure decanting to convert to a directed trust will be easily and readily allowable in most cases (unless decanting language in the older trust document supports such directed-trust change).

For example, an older trust document that includes only corporate trustees may likely face a steep hurdle for a modification or decanting allowing directed trustees; the rationale being that there is no intent reflected in the document that the settlor wished to have anyone other than the corporate trustee oversee the administration and management of the trust. *See, e.g., In re Tr. of Flint*, 118 A.3d 182 (Del. Ch. 2015)(request to modify testamentary trust to convert to a directed trust denied; no clear and convincing evidence of decedent's intent).

Three. My initial drafting approach for a trust document in response to the new Georgia UDTA provisions is not to include a separate section in the trust document with all possible bells and whistles in contemplation of each

future directed trustee. This is too unpredictable and cumbersome. What I believe is sufficient (at this early stage of the UDTA) is a broader, blanket provision in the trust document that refers to the UDTA provisions and allows directed trustees, in similar manner as the sample language I include as **Exhibit A** to this newsletter. **Exhibit A** is only a sample draft and no reader should rely on the draft language as a specific recommendation from me. It is merely for discussion purposes for this newsletter. The trust director can then, as needed and from time to time, enter into a separate written agreement with the directed trustee in line with the terms of this **Exhibit A**, as long as the written agreement is not inconsistent with the trust document provisions.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

James M. Kane

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Exhibit A

Article XII. Directed Trust Provisions

12.1 I am aware the State of Georgia has state law provisions modeled after the Uniform Directed Trust Act (UDTA), set forth under O.C.G.A. Section 53-12-500 *et seq.*, that permit an advisor, sometimes referred to as a "trust director", to direct

that one or more different trustees exercise certain ministerial and discretionary trustee functions, such, but not limited to, investment management pertaining to all or a portion of the trust assets, trust administration, distributions, tax reporting, transfer of trust situs, modifications or amendments to the trust agreement, when beneficiaries are to receive notice and information, and so forth. For purposes of this trust agreement, the then-acting individual Trustee or Co-Trustees under **Article XIV** shall, in a non-trustee individual capacity notwithstanding that he or she is also then serving as a trustee, at any time and from time to time have the authority as a "trust director" to exercise the powers as trust director as contemplated by these directed trust statutory provisions under this **Article XII**, as such "trust director" is defined and referenced under O.C.G.A. Section 53-12-500 *et seq*.

12.2 In accordance with the above statutory provisions under O.C.G.A. Section 53-12-500 et seq., as amended. I am including this **Article XII** to empower a trust director to exercise his or her power of direction to another trustee (called a "directed trustee"), whether or not I have named any such other directed trustee(s) in this trust agreement, and for the trust director to provide, upon written acceptance from the directed trustee(s), that such directed trustee(s) shall agree to and assume the fiduciary duties and liabilities as directed by the trust director until such time as the trust director or the directed trustee terminate the direction by written notice.

12.3 The trust director may enter into a written agreement supplemental to (and separate from) this trust agreement with a directed trustee defining and setting forth the scope of the directed trustee’s duties, powers, and responsibilities to the extent such powers are included under **Article XVI** *[cross-reference to the trustee powers]*, as amended, of this trust agreement and not inconsistent with the provisions of this trust agreement or O.C.G.A. Section 53-12-500 *et seq.* No such written agreement shall have the effect of removing a directed trustee’s liability for gross negligence or willful misconduct.

12.4 A directed trustee shall be subject to section 13.1 and also not be liable for taking reasonable action to comply with the trust director's exercise or non-exercise of the power of direction,

provided, however, that a directed trustee must not comply with the trust director's exercise or non-exercise of a power of direction to the extent that, by so complying, the directed trustee would be engaging in gross negligence or willful misconduct. I hereby also incorporate by reference herein the provisions of O.C.G.A. Sections 53-12-503 and 53-12-504, as amended, as to, but not limited to, the respective roles of "trust director" and a "directed trustee" and their respective duties; provided, however, the express provisions of this trust agreement shall control (including **Article XVI**) *[cross-reference to the trustee powers]* if the above incorporated statutory provisions, as amended, conflict with any provision of this trust agreement.

12.5 I also understand the situs of this trust is presently Georgia. My intent is that if there later is a change in the situs of any trust or trusts under this trust agreement that such trust or trusts in any other jurisdiction include similar directed trust provisions to the extent reasonably available and practicable.

12.6 Regardless of any other provisions in this trust agreement to the contrary, my wife **Jane**, as a trust director, may at any time and from time to time name and designate any one or more directed trustee in accordance with this **Article XII**; and if **Jane** for any reason is unable to make such naming or designation, my children together by unanimous agreement, collectively as trust director, who are at such time 30 years or older at that time and from time to time thereafter may name and designate any one or more directed trustee in accord with this **Article XII**.