

# **DIRECTED TRUSTS: CAN DIRECTED TRUSTEES LIMIT THEIR LIABILITY?**

Richard W. Nenno, Esquire  
Managing Director and Trust Counsel  
Wilmington Trust Company  
Rodney Square North  
1100 North Market Street  
Wilmington, Delaware 19890-0955  
Tel: (302) 651-8113  
Fax: (302) 651-1981  
rnenno@wilmingtontrust.com

March 27, 2007

©2007 Wilmington Trust Corporation. Affiliates in California, Connecticut, Delaware, Florida, Georgia, Maryland, Nevada, New Jersey, New York, Pennsylvania, South Carolina, Vermont, London, Dublin, Frankfurt, Channel Islands, and Cayman Islands.

This paper is not designed or intended to provide financial, tax, legal, accounting, or other professional advice because such advice always requires consideration of individual circumstances. If professional advice is needed, the services of a professional adviser should be sought.

Table of Contents

Page

I.	INTRODUCTION .....	1
A.	Background.....	1
B.	Scope.....	1
II.	STATE STATUTES .....	2
A.	Introduction.....	2
B.	Restatement Approach.....	2
C.	UTC Approach.....	4
D.	Protective Approach.....	5
E.	No Statute.....	5
F.	Delaware’s Experience .....	6
G.	Caselaw .....	6
III.	CLIENTS’ ABILITY TO SELECT TRUST STATES .....	7
A.	Introduction.....	7
B.	Choice-of-Law Principles .....	7
C.	Definitions.....	7
D.	Designation of Governing Law.....	8
E.	Application of Principles .....	10
F.	Matters of “Strong Public Policy” .....	11
G.	UTC Approach.....	12
H.	Implications.....	13
IV.	MOVING A DIRECTED TRUST TO A MORE PROTECTIVE STATE .....	13
A.	Introduction.....	13
1.	Background.....	13
2.	Roadblocks to Moving a Directed Trust.....	13
3.	Comments .....	14
4.	Issues to Consider .....	14
B.	Determining Whether the Directed Trust Can and Should Be Moved .....	15
C.	Federal Transfer-Tax Consequences of Moving.....	17
D.	Converting an Existing Trust Into a Directed Trust.....	18
Appendix A	State Directed Trust Statute Citations.....	19
Appendix B	Sample Directed Trust Language.....	22

## I. INTRODUCTION

### A. Background<sup>1</sup>

Clients sometimes want to appoint a corporate trustee for a trust but also want to have a cotrustee, adviser, committee, or protector (not the corporate trustee) control certain trust decisions. For example, if a trustor funds an inter vivos trust with stock in the family company, he or she might want to continue to make decisions regarding the purchase, sale, and voting of such stock. Similarly, a family that has a long-standing relationship with a successful money manager might want that manager (not the corporate trustee) to make investment decisions for trust assets. In addition, a client might want someone other than the corporate trustee to decide when to make income or principal distributions to beneficiaries. In these situations, the client wants to minimize the corporate trustee's involvement in such decisions and wants such trustee to lower its fees to reflect its reduced duties.

Unfortunately, even if a trust directs the corporate trustee to make investments or distributions on the direction of someone else and relieves it from liability for following such directions, such trustee might have considerable monitoring or other responsibilities under applicable state law. Thus, the corporate trustee might be in the unenviable position of being pressured to charge low fees while being subject to substantial potential liability.

### B. Scope

In this paper, I will explore the extent to which a client, the beneficiaries of a trust, and the corporate trustee may relieve the corporate trustee of liability in a "directed trust" (i.e., an irrevocable trust in which a cotrustee, adviser, committee, or protector directs the corporate trustee on investment and/or distribution decisions). Specifically, I will summarize the relevant state statutes and pertinent caselaw (Part II), explore the extent to which a trustor or testator may select the directed trust statute of a state where he or she does not live (Part III), and consider whether an existing directed trust may be moved to another state in order to provide more protection to the corporate trustee (Part IV). Appendix A gives state statute citations, and Appendix B provides sample language.

---

<sup>1</sup> For discussions of directed trusts, see Dennis I. Belcher, Not My Fault—The Devil Made Me Do It! Responsibilities and Duties of a Delegating or Directed Trustee, 41 U. Miami Inst. on Est. Plan. 11-1 (2007); Al W. King, III, & Pierce H. McDowell, III, Delegated vs. Directed Trusts, 145 Tr. & Est. 26 (July 2006); Stewart E. Sterk, Trust Protectors, Agency Costs, and Fiduciary Duty, 27 Cardozo L. Rev. 2761 (Apr. 2006). In this paper, I refer to the following sources: 2A Austin W. Scott & William F. Fratcher, The Law of Trusts § 185 at 562–80 (4th ed. 1987); 5A Austin W. Scott & William F. Fratcher, The Law of Trusts (4th ed. 1989); George G. Bogert & George T. Bogert, The Law of Trusts and Trustees (rev. 2d ed. 1992).

## II. STATE STATUTES

### A. Introduction

For directed trusts, some states follow the approach of § 185 of the Second Restatement of Trusts,<sup>2</sup> other states follow § 808(b) of the Uniform Trust Code (“UTC”),<sup>3</sup> still other states have statutes that greatly limit a trustee's liability, and other states have no relevant statute. Appendix A contains citations for the foregoing statutes.

### B. Restatement Approach

Section 185 of the Second Restatement of Trusts provides as follows:<sup>4</sup>

If under the terms of the 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.

Ordinarily, a trustee must follow the directions of someone who is given a power to direct in the trust instrument and may be held liable for not doing so.<sup>5</sup> If the power on which the trustee is directed is for the sole benefit of the directing person (e.g., a power in a widow to direct the sale of trust real estate), the trustee's sole responsibility is to ensure that the direction is within the terms of the trust.<sup>6</sup> If the power on which the trustee is directed is held by the directing person in a fiduciary capacity for the beneficiaries of the trust, however, the trustee might have to make sure that the directing person does not violate that duty and might have to petition a court for instructions in certain cases.<sup>7</sup> Ordinarily, the trustee may await instructions from the directing person but, in certain situations, might have to suggest that the directing person take action or to petition a court for instructions.<sup>8</sup>

The Scott treatise discusses the subject as follows:<sup>9</sup>

---

<sup>2</sup> Restatement (Second) of Trusts § 185 (1959).

<sup>3</sup> UTC § 808(b) (2005). The current text of the UTC and the jurisdictions that have adopted the UTC are [available at www.utproject.org](http://www.utproject.org) (last visited Mar. 26, 2007).

<sup>4</sup> Restatement (Second) of Trusts § 185 (1959).

<sup>5</sup> *Id.* cmt. b.

<sup>6</sup> *Id.* cmts. c–d.

<sup>7</sup> *Id.* cmts. c, e.

<sup>8</sup> *Id.* cmt. f.

<sup>9</sup> 2A Scott & Fratcher, *supra* note 1, at 574–75 (footnotes omitted).

Where the holder of the power holds it solely for his own benefit, the trustee can properly comply and is under a duty to comply with his directions, provided that the attempted exercise of the power does not violate the terms of the trust. But where the holder of the power holds it as a fiduciary, the trustee is not justified in complying with his directions if the trustee knows or ought to know that the holder of the power is violating his duty to the beneficiaries as fiduciary in giving the directions. The trustee cannot properly take the position that the responsibility is wholly that of the holder of the power. In such a case the trustee is under a duty similar to that which one trustee owes with respect to his co-trustees. A trustee is not always justified in complying strictly with the terms of the trust. As has been stated, where the trustee is forbidden by the terms of the trust to sell certain property, but where, owing to circumstances not known to the settlor and not anticipated by him, compliance with the provision would defeat or substantially impair the accomplishment of the purposes of the trust, he can apply to a proper court for a direction or permission to deviate from the terms of the trust, and he may be liable for failure to apply to the court, if he knew or reasonably should have known of the existence of those circumstances. It seems even more clear that where it is provided that the trustee should comply with the directions of another, but he knows or reasonably should know that the other in giving directions is violating his duty, the trustee is under a duty to the beneficiaries to apply to the court for permission not to comply with the directions.

The trustee is not necessarily justified in complying with the directions of the holder of the power merely because he does not actually know that the latter is violating his duty as fiduciary. He is liable if he should know of the violation of duty. He is ordinarily under a duty to make a reasonable inquiry and investigation in order to determine whether the holder of the power is violating his duty. Thus, if it is provided that the trustee shall make such

investments as a third person shall direct, it is ordinarily the duty of the trustee to make some investigation into the propriety of the investment. If as a result he believes that the holder of the power is abusing the discretion conferred on him in directing the investment, he should inform him of this. If the holder of the power still insists on his making the investment, the trustee should apply to the court for instructions.

As shown in Appendix A, only two states—Indiana and Iowa—have statutes based on § 185.

Section 185 is not comforting to directed trustees because they must devote resources to ensuring that the directing person is not violating the terms of the trust or a fiduciary duty.

C. UTC Approach

For the most part, the UTC is not more helpful to directed trustees than Restatement § 185. Subsection (b) of UTC § 808 provides as follows:<sup>10</sup>

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.

Section 808's comment discusses subsection (b) as follows:<sup>11</sup>

Powers to direct are most effective when the trustee is not deterred from exercising the power by fear of possible liability. On the other hand, the trustee does have overall responsibility for seeing that the terms of the trust are honored. For this reason, subsection (b) imposes only minimal oversight responsibility on the trustee. A trustee must generally act in accordance with the direction. A trustee may refuse the direction only if the

---

<sup>10</sup> UTC § 808(b) (2005).

<sup>11</sup> Id. cmt.

attempted exercise would be manifestly contrary to the terms of the trust or the trustee knows the attempted exercise would constitute a serious breach of a fiduciary duty owed by the holder of the power to the beneficiaries of the trust.

The comment to § 808 does continue, though, that:<sup>12</sup>

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. Or a settlor could provide that the holder of the power is not to be held to the standards of a fiduciary.

Again, unless the governing instrument provides otherwise, a directed trustee must devote considerable resources to ensure that the directing person's action is not "manifestly contrary to the terms of the trust" or "a serious breach of a fiduciary duty."

As shown in Appendix A, 17 states—Alabama, Arkansas, the District of Columbia, Florida, Kansas, Maine, Missouri, Nebraska, New Hampshire, New Mexico, North Carolina, Oregon, Pennsylvania, South Carolina, Texas, Virginia, and Wyoming—have statutes based on UTC § 808(b).

D. Protective Approach

As shown in Appendix A, 9 states—Colorado, Delaware, Georgia, Idaho, Indiana, Ohio, Oklahoma, South Dakota, and Tennessee—afford more protection to directed trustees than Restatement § 185 or UTC § 808(b). For example, a Delaware trustee is liable for following a distribution or investment direction only if it engages in willful misconduct. Some other states only extend protection to directed trustees in investment matters, some require the directed trustee to carry out the direction properly, and some place no restrictions on the directed trustee's conduct.

E. No Statute

As shown in Appendix A, 23 states—Alaska, Arizona, California, Connecticut, Hawaii, Illinois, Kentucky, Louisiana, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Montana, Nevada, New Jersey, New York, North Dakota, Rhode Island, Vermont, Washington, West Virginia, and Wisconsin—have no directed trust statute.

---

<sup>12</sup> Id. (citation omitted).

F. Delaware's Experience

In Delaware, a trustee that makes distributions on the direction of an adviser appointed in the trust instrument is not liable to the beneficiaries for a breach of trust.<sup>13</sup> Based on the Delaware statute, Delaware trusts often permit individual cotrustees, advisers, and/or protectors to direct the corporate trustee regarding distribution decisions.

Delaware's statute also permits someone other than the trustee to make investment decisions for particular assets (e.g., closely held stock) or with the hope of maximizing the trust's investment performance and makes it clear that a trustee may follow the direction of an adviser authorized by the governing instrument to give such direction without breaching the trustee's fiduciary responsibility.<sup>14</sup> To recognize this diminished responsibility under the Delaware statute, Delaware corporate trustees customarily charge less to administer directed trusts than trusts over which they have investment duties. A 2004 case upheld the Delaware statute.<sup>15</sup>

G. Caselaw

Two reported cases have involved directed trusts:

In Duemler v. Wilmington Trust Company,<sup>16</sup> A Delaware Vice Chancellor ruled that a corporate trustee was not liable for the failure of a sophisticated (i.e., securities lawyer) investment adviser to direct it on an investment decision where the trustee forwarded relevant information to the adviser.

In Rollins v. Branch Banking & Trust Co. of Va.,<sup>17</sup> a Virginia trial court held that a trustee was not liable for the \$25 million loss caused by the retention of stock as directed by the beneficiaries. But, the court did not dismiss the beneficiaries' claim that the trustee violated a duty to warn them about the deterioration in a company's financial condition, and the case was settled on this issue.

---

<sup>13</sup> Del. Code Ann. tit. 12, § 3313.

<sup>14</sup> Id.

<sup>15</sup> Duemler v. Wilmington Trust Co., Del. Ch., C.A. 20033 NC, 2004, Strine, V.C. (Nov. 24, 2004).

<sup>16</sup> Id.

<sup>17</sup> Rollins v. Branch Banking & Trust Co. of Va., 2001 Va. Cir. Lexis 146 (Va. Cir. Ct. 2001).

### III. CLIENTS' ABILITY TO SELECT TRUST STATES

#### A. Introduction

This Part III summarizes the rules in the Second Restatement of Conflict of Laws and the UTC regarding which state's law governs various aspects of the administration of a trust.

#### B. Choice-of-Law Principles

To determine how much latitude a client who resides in one state ("Home State") has to select the law of another state ("Trust State") to govern a trust that he or she creates, it is necessary to analyze the conflict-of-law principles that have been developed in trust matters.<sup>18</sup> These matters are covered in Chapter 10 of the Second Restatement of Conflict of Laws,<sup>19</sup> Chapter 14 of the Scott treatise,<sup>20</sup> and Chapter 16 of the Bogert treatise.<sup>21</sup> The client's latitude in this regard is a function of whether the trust is an inter vivos trust or a testamentary trust, whether the trust contains personal property or real property, and whether the issue in question involves the trust's "validity," "construction," or "administration."

#### C. Definitions

Questions involving the "validity"<sup>22</sup> of trust provisions relate to matters such as whether the trust violates the rule against perpetuities or a rule against accumulations.<sup>23</sup> Questions involving the "construction"<sup>24</sup> of a trust relate to matters such as the identity of the beneficiaries, their respective interests, and, in most cases, allocations between principal and income.<sup>25</sup> Questions of trust

---

<sup>18</sup> For convenience, I will refer to the District of Columbia and each of the 50 states as a "state."

<sup>19</sup> Restatement (Second) of Conflict of Laws §§ 267–282 (1971).

<sup>20</sup> 5A Scott & Fratcher, supra note 1, §§ 553–666.

<sup>21</sup> Bogert & Bogert, supra note 1, §§ 291–301.

<sup>22</sup> See Restatement (Second) of Conflict of Laws § 269 (1971), 5A Scott & Fratcher, supra note 1, §§ 555, 587–596A, Bogert & Bogert, supra note 1, § 296 (testamentary trusts of personal property); Restatement (Second) of Conflict of Laws § 270 (1971), 5A Scott & Fratcher, supra note 1, §§ 555, 587, 597–603, Bogert & Bogert, supra note 1, § 297 (inter vivos trusts of personal property); Restatement (Second) of Conflict of Laws § 278 (1971), 5A Scott & Fratcher, supra note 1, §§ 643, 649–651, Bogert & Bogert, supra note 1, § 296 (testamentary trusts of real property); Restatement (Second) of Conflict of Laws § 278 (1971), 5A Scott & Fratcher, supra note 1, §§ 643, 652, Bogert & Bogert, supra note 1, § 297 (inter vivos trusts of real property).

<sup>23</sup> Restatement (Second) of Conflict of Laws § 269 cmt. d (1971), Bogert & Bogert, supra note 1, § 293 at 253–54.

<sup>24</sup> See Restatement (Second) of Conflict of Laws § 268 (1971), 5A Scott & Fratcher, supra note 1, §§ 555, 574–578, 581–586, Bogert & Bogert, supra note 1, § 296 (testamentary trusts of personal property); Restatement (Second) of Conflict of Laws § 268 (1971), 5A Scott & Fratcher, supra note 1, §§ 555, 574–576, 578–586, Bogert & Bogert, supra note 1, § 297 (inter vivos trusts of personal property); Restatement (Second) of Conflict of Laws § 277 (1971), 5A Scott & Fratcher, supra note 1, §§ 643, 648, Bogert & Bogert, supra note 1, § 296 (testamentary and inter vivos trusts of real property).

<sup>25</sup> Restatement (Second) of Conflict of Laws § 271 cmt. a, § 268 cmt. h (1971), Bogert & Bogert, supra note 1, § 293 at 252.

“administration”<sup>26</sup> involve matters such as the powers and duties of the trustee, trust investments, compensation of the trustee and its right to indemnity, liability for breach of trust, and the power of the beneficiaries to terminate the trust.<sup>27</sup>

D. Designation of Governing Law

When creating a new trust, a client may and should designate the law of the Trust State that will govern matters of validity, construction, and administration. The Bogert treatise summarizes the effect of such a designation under the Second Restatement of Conflict of Laws as follows:<sup>28</sup>

(A) As to interests in personal property held in a testamentary trust:

1. A testator may designate the local law to govern the validity of the trust, except that (a) his designation will not control if application of the designated law would be contrary to a “strong public policy” of the state of his domicile at death and (b) the designated state must have a “substantial relation” to the trust. A substantial relation exists when the designated state is that in which the trust is administered or in which the trustee has his place of business or his domicile at his death, or is the state of the domicile of the beneficiaries.
2. A testator may designate the state whose local law is to govern construction of the terms of the trust, and it is not required that the designated state have any connection with the trust.

---

<sup>26</sup> See Restatement (Second) of Conflict of Laws § 271 (1971), 5A Scott & Fratcher, supra note 1, §§ 555, 604–609, 622, Bogert & Bogert, supra note 1, § 296 (testamentary trusts of personal property); Restatement (Second) of Conflict of Laws § 272 (1971), 5A Scott & Fratcher, supra note 1, §§ 555, 604, 610–612, 622, Bogert & Bogert, supra note 1, § 297 (inter vivos trusts of personal property); Restatement (Second) of Conflict of Laws § 279 (1971), 5A Scott & Fratcher, supra note 1, §§ 643, 659, Bogert & Bogert, supra note 1, § 296 (testamentary trusts of real property); Restatement (Second) of Conflict of Laws § 279 (1971), 5A Scott & Fratcher, supra note 1, §§ 643, 659, Bogert & Bogert, supra note 1, § 297 (inter vivos trusts of real property).

<sup>27</sup> See Restatement (Second) of Conflict of Laws § 271 cmt. a (1971), Bogert & Bogert, supra note 1, § 293 at 253.

<sup>28</sup> Bogert & Bogert, supra note 1, § 301 at 332–33 (emphasis in original).

3. A testator may designate the local law of one state to govern administration of the trust even though that state has no relation to the trust, except that on public policy grounds certain matters of administration cannot be controlled by the trust terms. These matters include attempts to grant the testamentary trustee exoneration from liability for failure to exercise prudence or for acts of self-dealing, or a power to fix the value of trust assets for all purposes.

(B) As to interests in personal property held in a living trust:

1. The settlor of a living trust may designate the local law of one state to govern the validity of the trust (a) if that state has a substantial relation to the trust and (b) if application of its local law does not violate a “strong public policy of the state with which as to the matter at issue the trust has its most significant relationship.”
2. As in the case of a testamentary trust, a settlor may designate the state whose local law is to govern construction under the terms of the trust; the designated state need not have any connection with the trust.
3. Except where matters of administration cannot be controlled by the trust terms on public policy grounds, a settlor may designate the local law of one state to govern administration of the trust even though that state has no relation to the trust.

(C) As to trust interests in real property:

The opportunity of a testator or settlor of a trust of land to effectively designate a local law of a state other than that of the situs of the land to govern the validity and administration of a trust of land is more limited. The effectiveness of such a designation will depend upon whether the situs courts recognize the designated state as having a more significant relationship to the particular issue than the situs state.

Generally speaking, questions relating to the validity or administration of a trust of land, whether living or testamentary, will be governed by the law that would be applied by the courts of the situs state, in most cases (but not necessarily) its own local law. The “legal effect” of a trust of land, as that term has been defined hereinabove (section 293), will depend upon the local law of the situs of the land. As in the case of a trust of personal property, the courts will give effect to a provision in the trust instrument that the trust of land should be construed in accordance with the rules of construction in effect in a particular state, whether or not those of the situs state.

E. Application of Principles

The Second Restatement of Conflict of Laws defines matters of trust “administration” as follows:<sup>29</sup>

The term “administration of a trust,” as it is used in the Restatement of this Subject, includes those matters which relate to the management of the trust. Matters of administration include those relating to the duties owed by the trustee to the beneficiaries. They include the powers of a trustee, such as the power to lease, to sell and to pledge, the exercise of discretionary powers, the requirement of unanimity of the trustees in the exercise of powers, and the

---

<sup>29</sup> Restatement (Second) of Conflict of Laws § 271 cmt. a (1971) (citations omitted).

survival of powers. They include the liabilities which may be incurred by the trustee for breach of trust. They include questions as to what are proper trust investments. They include the trustee's right to compensation. They include the trustee's right to indemnity for expenses incurred by him in the administration of the trust. They include the removal of the trustee and the appointment of successor trustees. They include the terminability of the trust. . . .

On the other hand, where the question is as to who are beneficiaries of the trust and as to the extent of their interests, the question is one of construction rather than of administration . . . .

The operation of a directed trust and the directed trustee's liability under it clearly are matters of trust administration.

For an inter vivos trust that holds interests in personal property, the ability of a trustor to designate the law of a Trust State to govern matters of administration (e.g., the effectiveness of a directed trust) is as follows:<sup>30</sup>

The administration of an inter vivos trust of interests in movables is governed as to matters which can be controlled by the terms of the trust

- (a) by the local law of the state designated by the settlor to govern the administration of the trust, or
- (b) if there is no such designation, by the local law of the state to which the administration of the trust is most substantially related.

The designated state need not be the trustor's Home State or have any other connection with the administration of the trust.<sup>31</sup>

#### F. Matters of "Strong Public Policy"

The designation of a Trust State's law to govern the administration of a testamentary trust that holds personal property on matters which cannot be controlled by the terms of the trust might not be honored if the matter in question contravenes a "strong public policy" of the testator's Home State.<sup>32</sup> Under the Restatement, these matters are as follows:<sup>33</sup>

---

<sup>30</sup> Restatement (Second) of Conflict of Laws § 272 (1971).

<sup>31</sup> Id. cmt. c.

<sup>32</sup> Id. § 271 cmt. h.

<sup>33</sup> Id.

Certain matters of administration may be such that the testator cannot regulate them by any provision in the terms of the trust. Thus, by a statute of the testator's domicile it may be provided that the attempted grant to a testamentary trustee of exoneration from liability for failure to exercise reasonable care, diligence and prudence, or a power to make a binding and conclusive fixation of the value of any asset for purposes of distribution or allocation, shall be deemed contrary to public policy. So also, under the local law of the state of the testator's domicile there may be unusually strict rules as to self-dealing. If a testator fixes the administration of a trust in a state other than that of his domicile, it is not certain whether the courts will apply the rule of the domicile or the rule of the place of administration.

The legal effect of a directed trust does not fall within any of the above exceptions to the general rule, and it does not seem to me that this arrangement should be offensive to strong public policy. In any event, for inter vivos trusts of personal property, the Restatement indicates that the law of the Trust State should apply to this issue:<sup>34</sup>

Certain matters of administration may be such that the settlor cannot regulate them by any provision in the terms of the trust. In the case of an inter vivos trust the applicable law is probably the local law of the state in which the administration of the trust is fixed.

#### G. UTC Approach

Section 107 of the UTC provides in relevant part that:<sup>35</sup>

The meaning and effect of the terms of a trust are determined by:

- (1) the law of the jurisdiction designated in the terms unless the designation of that jurisdiction's law is contrary to a strong public policy of the jurisdiction having the most significant relationship to the matter at issue . . . .

---

<sup>34</sup> Id., § 272 cmt. f (citation omitted).

<sup>35</sup> UTC § 107(1) (2005).

Like the Second Restatement of Conflict of Laws, a designation of a governing law for questions of administration under the UTC requires no other connection with the Trust State.<sup>36</sup> The UTC intentionally does not specify the strong public policies that will invalidate a designation.<sup>37</sup> Because a directed trust should not be objectionable under the Restatement, it should not be under the UTC either.

#### H. Implications

Although some attorneys do not look beyond the states in which they are admitted to practice when they advise clients on the creation of trusts, other attorneys actively work with clients to find the best state for their trusts. A recent study found that:<sup>38</sup>

Our estimates imply that, [from 1987] through 2003, the movement to abolish the Rule Against Perpetuities has affected the situs of \$100 billion in [federally] reported trust assets—roughly 10% of the 2003 total.

Thus, if a client's Home State does not protect a directed trustee sufficiently, the client and his or her attorney should consider designating the law of another state to govern this issue.

### IV. MOVING A DIRECTED TRUST TO A MORE PROTECTIVE STATE

#### A. Introduction

##### 1. Background

The beneficiaries and trustees of an existing directed trust might investigate whether they may change the law that governs the trust's administration in order to increase the protection afforded to the directed trustee and thereby facilitate the administration of the trust.

##### 2. Roadblocks to Moving a Directed Trust

In descending order of frequency, here are the most common roadblocks to moving a directed trust:<sup>39</sup>

---

<sup>36</sup> Id. cmt.

<sup>37</sup> Id.

<sup>38</sup> Robert H. Sitkoff & Max M. Schanzenbach, Jurisdictional Competition for Trust Funds: An Empirical Analysis of Perpetuities and Taxes, 115 Yale L. J. 356, 412 (2005).

<sup>39</sup> This information is based on comments made by Carol A. Johnston, Joshua S. Rubenstein, W. Donald Sparks, II, and me at The Nuts and Bolts of Changing the Situs of a Trust, 40 U. Miami Inst. on Est. Plan. Special Sess. 3-B (Jan. 12, 2006).

- a. Lack of agreement among the beneficiaries;
- b. Lack of appropriate language in the governing instrument;
- c. Court intervention (e.g., refusal of a court to permit the move or excessive cost of a court proceeding);
- d. Fee issues (e.g., principal termination fee for current trustee; excessive fees of new trustee);
- e. Uncooperative trustees;
- f. Accounting requirements and liability issues (e.g., releases and indemnifications);
- g. Choice of law issues;
- h. Conflict of interest issues;
- i. Involvement of guardian or trustee ad litem who objects to the move;
- j. Inability to terminate all ties to the original jurisdiction.

3. Comments

Although beneficiaries and trustees might have valid reasons to move a directed trust, the story might not have a happy ending because one or more of the above roadblocks might make it impossible or impracticable to make the change. Accordingly, it is essential in the creation of a new directed trust to select the right trustees, situs, and governing law and to include appropriate language in case a change is needed in the future.

4. Issues to Consider

To determine whether a directed trust may be moved to take advantage of another state's favorable laws, three separate issues must be addressed:

- a. Whether it is possible to move the directed trust, either with or without court proceedings;
- b. Whether the desired benefits available are significant enough to justify the costs and risks that will be incurred as a result of the move; and

- c. Whether any procedural steps are available to ensure that the directed trust's move will be respected by the original state.

To address these issues properly, the terms of the governing instrument, the applicable law of the original state, the factual circumstances of the trust, and federal constitutional issues must all be considered.

## B. Determining Whether the Directed Trust Can and Should Be Moved

The transfer of a directed trust's situs from one state to another might be accomplished through an express provision in the trust instrument, a pertinent statute,<sup>40</sup> or a court petition. Generally, the courts have permitted the transfer of a trust when there is no contrary intent expressed in the trust instrument and the administration of the trust will be facilitated and the interests of the beneficiaries will be promoted.<sup>41</sup> Trustees and beneficiaries should not assume, though, that courts automatically will grant petitions to transfer situs. For example, courts have denied such petitions when the accomplishment of the stated objective—the avoidance of New York income tax—did not require the change.<sup>42</sup>

Moving the situs of a directed trust, in the traditional sense of moving its principal place of administration from one state to another, does not automatically result in a change in the law that applies.<sup>43</sup> If the governing instrument does not specify that, upon a change in situs, the laws of the new state will apply, then a conflict-of-laws analysis is needed to determine whether the directed trust can avail itself of the favorable laws of the new state. That analysis is dependent on whether the question at issue involves a matter of trust validity, construction, or administration; whether the trust is an inter vivos trust or a testamentary trust; and whether the issue involves real property or personal property.<sup>44</sup>

As I discussed in Paragraphs D and E of Part III above, a client's designation in a trust instrument of a state's law to govern its administration will be effective in most circumstances.<sup>45</sup> If the governing instrument is silent and if the question involves personal property, matters of administration typically are determined, in the case of a testamentary trust, by the law of the state in which the trust is to be administered<sup>46</sup> and, in the case of an inter vivos trust, by the law of the state to which the administration of the trust is most substantially related.<sup>47</sup> If the governing instrument is silent and if the question involves an interest in real

---

<sup>40</sup> See, e.g., Cal. Prob. Code §§ 17400–17405. See 5A Scott & Fratcher, *supra* note 1, § 614 at 363–65 n.26.

<sup>41</sup> See *In re Estate of McComas*, 165 Misc. 2d 947, 948 (Surr. Ct. N.Y. Co. 1995).

<sup>42</sup> *In re Bush*, 2 Misc. 3d 744 (Surr. Ct. N.Y. Co. 2003); *In re Application for Judicial Approval of the Resignation of the Chase Manhattan Bank*, 2 Misc. 3d 554 (Surr. Ct. N.Y. Co. 2003).

<sup>43</sup> 5A Scott & Fratcher, *supra* note 1, § 615 at 369.

<sup>44</sup> Restatement (Second) of Conflict of Laws §§ 267–282 (1971).

<sup>45</sup> Paragraph C of Part III summarizes the distinction among questions of validity, construction, and administration.

<sup>46</sup> Restatement (Second) of Conflict of Laws § 271(b) (1971).

<sup>47</sup> *Id.* § 272(b).

property, questions involving the administration of a trust, testamentary or inter vivos, generally are resolved under the law that would be applied by the courts of the state where the real property is located.<sup>48</sup>

The Delaware courts have looked to a number of factors in determining what governing law should apply in interpreting or administering trusts. These factors include the location of the trustee, the location where the assets in the trust are held, any governing law provisions set forth in the trust instrument, the domicile of the testator (in the case of a testamentary trust) or the domicile of the trustor (in the case of an inter vivos trust), and the location of the beneficiaries of the trust. In Delaware cases that involve inter vivos trusts, in the absence of an explicit governing law provision, the courts have tended to emphasize the location of the trustee and the location of the administration of the trust as the most significant factors in determining the nexus for the application of the appropriate governing law.<sup>49</sup>

In assessing whether it makes sense to pursue moving a directed trust, consideration must be given to the necessary procedures to accomplish the move, in both the old and the new state. If the governing instrument provides for the removal and replacement of the trustee without the necessity for court proceedings, the nomination of a trustee in the more favorable state may be sufficient in itself to accomplish the transfer of the situs. Similarly, the governing instrument might confer powers of appointment that may be exercised by the beneficiaries in a way that will accomplish the transfer of situs without court intervention. Frequently, however, the governing instrument is silent on the issues of removal, resignation, and replacement or does not contain powers of appointment. In such a case, the beneficiaries must either obtain the trustee's agreement to resign or convince the local probate court to remove the trustee. In this connection, § 706 of the UTC<sup>50</sup> or a local statute<sup>51</sup> might provide courts with bases for removing a trustee.

To move a directed trust in conjunction with the resignation or removal of a trustee, the beneficiaries or the trustee must file a petition (often accompanied by an accounting) in the local probate court. In many instances, it also is necessary to file a petition in a court in the new state seeking the court's approval of the transfer of situs and acceptance of jurisdiction over the trust prior to the proceeding in the local probate court. Thus, the local court knows of the new trustee's willingness to serve and the new court's acceptance of jurisdiction upon the local court's approval of transfer.

---

<sup>48</sup> Id. §§ 278, 277(2), 279.

<sup>49</sup> See Lewis v. Hanson, 128 A.2d 819, 826 (Del. 1957), aff'd sub nom. Hanson v. Denckla, 357 U.S. 235 (1958).

<sup>50</sup> UTC § 706 (2005).

<sup>51</sup> See, e.g., Conn. Gen. Stat. § 45a-242; Del. Code Ann. tit. 12, § 3327; Mo. Rev. Stat. § 456.7-706.

The Scott treatise describes the impact of the move of a trust that effects a change in the law that governs its administration as follows:<sup>52</sup>

Although a change in the place of administration is authorized, any resulting change in the applicable law will presumably include only matters of administration. The law of the new place of administration will probably be applicable to the compensation of the trustee, the scope of permissible investments, and the powers and duties of the trustee. On the other hand, the change in the place of administration will not affect those matters that pertain to the disposition of the trust property. Thus the change in the place of administration will not affect the determination of who are the beneficiaries of the trust or probably the allocation of receipts and expenses to income or principal. Presumably as to these matters the settlor or testator did not intend to make applicable the law of the place of administration nor did he intend to change the applicable law merely because he permitted a change in the place of administration.

Some states facilitate the application of their laws to the administration of trusts moved from other states. For example, a Delaware statute provides that Delaware law governs the administration of a trust unless the governing instrument or a court order provides otherwise.<sup>53</sup>

### C. Federal Transfer-Tax Consequences of Moving

The attorney must ensure that moving a directed trust will not produce adverse federal transfer-tax consequences. An exempt trust (i.e., a trust to which a testator or trustor allocated GST exemption) or a nonexempt trust (i.e., a trust that is not exempt or grandfathered for GST-tax purposes) probably may be moved without changing its federal transfer-tax status.

Unless or until the GST tax is repealed, however, the attorney must take great care in moving a grandfathered trust (i.e., a trust that was irrevocable on September 25, 1985) because the Internal Revenue Service (“IRS”) takes the position that a trust will lose its grandfathered status if it is moved to lengthen its duration.<sup>54</sup> But, moving a trust to a state that has a longer perpetuities period than that of the

---

<sup>52</sup> 5A Scott & Fratcher, supra note 1, § 615 at 369 (footnotes omitted). See Restatement (Second) of Conflict of Laws § 272 cmt. e (1971).

<sup>53</sup> Del. Code Ann. tit. 12, § 3332(b).

<sup>54</sup> Reg. § 26.2601-1(b)(4)(i)(E), Ex. 4.

original state will not lengthen a trust's duration if the trust instrument specifies that the trust must terminate on a particular date (e.g., at the end of the uniform statutory rule against perpetuities period or the common-law perpetuities period). A Delaware statute provides that the duration of a trust does not change merely because it is moved to Delaware.<sup>55</sup> In addition, a beneficiary of a grandfathered trust may not exercise a limited power of appointment to create a perpetual trust and preserve the trust's grandfathered status.<sup>56</sup>

Nevertheless, the IRS takes the position that moving a grandfathered trust to effect a change in its administrative provisions will not cost the trust its grandfathered status.<sup>57</sup> Hence, moving a grandfathered directed trust to a more protective jurisdiction should be acceptable.

#### D. Converting an Existing Trust Into a Directed Trust

The trustee and beneficiaries of an existing trust that does not contain directed trust provisions might want to convert it into a directed trust. This might be accomplished by the exercise of a power of appointment, a "decanting power" (i.e., a power that permits trustees who possess discretion to exercise that power in further trust),<sup>58</sup> or a judicial or nonjudicial power to amend or reform the trust.<sup>59</sup>

---

<sup>55</sup> Del Code Ann. tit. 12, § 3332(a).

<sup>56</sup> Reg. § 26.2601-1(b)(1)(v)(B).

<sup>57</sup> Reg. § 26.2601-1(b)(4)(i)(D)(2).

<sup>58</sup> See, e.g., Alaska Stat. § 13.36.157; Del. Code Ann. tit. 12, § 3528; N.Y. Est. Powers & Trusts Law § 10-6.6.

<sup>59</sup> See Joshua C. Tate, Conditional Love: Incentive Trusts and the Inflexibility Problem, 41 Real Prop., Prob. & Tr. J. 445, 466 (Fall 2006).

**APPENDIX A**

**STATE DIRECTED TRUST  
STATUTE CITATIONS**

## STATE DIRECTED TRUST STATUTE CITATIONS

**Follows § 185 of Second Restatement of Trusts (directed trustee liable if direction violates terms of trust or fiduciary duty of directing person)**

State	Citation
Indiana	Ind. Code Ann. § 30-4-3-9(b)
Iowa	Iowa Code § 633.4207(2)

**Follows § 808(b) of UTC (directed trustee liable if direction is manifestly contrary to terms of trust or trustee knows direction is serious breach of fiduciary duty of directing person)**

State	Citation
Alabama	Ala. Code § 19-3B-808(b)
Arkansas	Ark. Code Ann. § 28-73-808(b)
District of Columbia	D.C. Code § 19-1308.08(b)
Florida	Fla. Stat. § 736.0808(2)
Kansas	Kan. Stat. Ann. § 58a-808(b)
Maine	Me. Rev. Stat. Ann. tit. 18-B, § 808(2)
Missouri	Mo. Rev. Stat. § 456.8-808(2)
Nebraska	Neb. Rev. Stat. Ann. § 30-3873(b)
New Hampshire	N.H. Rev. Stat. Ann. § 564-B:8-808(b), 564-B:12-1206-1207
New Mexico	N.M. Stat. Ann. § 46A-8-808(B)
North Carolina	N.C. Gen. Stat. § 36C-8-808(b)
Oregon	Or. Rev. Stat. § 130.685(2)
Pennsylvania	20 Pa. Cons. Stat. § 7778(b)
South Carolina	S.C. Code Ann. § 62-7-808(b)
Texas	Tex. Prop. Code Ann. § 114.003(b)
Virginia	Va. Code Ann. § 55-548.08(B)
Wyoming	Wyo. Stat. Ann. § 4-10-808(b), 4-10-715, 4-10-717-718

**Provides Substantial Protection (directed trustee liable for deficient execution of direction, for willful misconduct, or not at all)**

State	Citation
Colorado (investment decisions only)	Colo. Rev. Stat. § 15-1-307
Delaware (willful misconduct)	Del. Code Ann. tit. 12, § 3313
Georgia (investment decisions only)	Ga. Code Ann. § 53-12-194(c)
Idaho	Idaho Code § 15-7-501
Indiana	Ind. Code Ann. § 30-4-3-9(a)
Ohio	Ohio Rev. Code Ann. §§ 5808.08(B), 5815.25(B), 2109.022(B)
Oklahoma (investment decisions only)	Okla. Stat. tit. 60, § 175.19
South Dakota	S.D. Codified Laws §§ 55-1B-1-3, 55-1B-5-6, 55-1B-9-11
Tennessee	Tenn. Code Ann. §§ 35-15-808, 35-3-122-123
Utah (willful misconduct or gross negligence; investment decisions only)	Utah Code Ann. § 75-7-906(4)

## STATE DIRECTED TRUST STATUTE CITATIONS

### Has No Directed Trust Statute

State	Citation
Alaska	
Arizona	
California	
Connecticut	
Hawaii	
Illinois	
Kentucky	
Louisiana	
Maryland	
Massachusetts	
Michigan	
Minnesota	
Mississippi	
Montana	
Nevada	
New Jersey	
New York	
North Dakota	
Rhode Island	
Vermont	
Washington	
West Virginia	
Wisconsin	

2/07

Note: I welcome corrections and additions to this chart.

**APPENDIX B**

**SAMPLE DIRECTED  
TRUST LANGUAGE**

## SECTION 7: TRUSTEE'S POWERS.

In addition to those powers granted by law, Trustee is specifically authorized and empowered, in its sole discretion, but subject to the provisions of Section 8:

A. To sell at public or private sale, exchange for like or unlike property, convey, lease for terms longer or shorter than the trust, and otherwise dispose of any or all property held hereunder, for such price and upon such terms and credits as it deems proper.

B. To invest in any kind of property, real, personal, or mixed, regardless of the laws governing investments by fiduciaries, without any duty to diversify investments.

C. Unless otherwise directed by the investment adviser named in Section 8 hereof, to execute securities transactions, without necessity of providing written confirmation thereof to such adviser at the time of settlement, and to execute securities transactions through any brokerage service, whether discount or full service, including Wilmington Brokerage Services at its normal rates of compensation, without diminution of compensation otherwise payable to Trustee, even if Wilmington Trust Company is serving as Trustee.

D. To vote directly or by proxy at any election or stockholders' meeting any shares of stock, excluding stock of Wilmington Trust Corporation.

E. To participate in any plan or proceeding, including any voting trust plan for liquidating, protecting, or enforcing any interest in any property, or for reorganizing, consolidating, merging, or adjusting the finances of any corporation issuing any such interest; to accept in lieu thereof any new or substituted stocks, bonds, notes, or securities, whether of the same or a different kind or class, or with different priorities, rights, or privileges; to pay any assessment or any expense incident thereto; and to do any other act or thing that it deems necessary or advisable in connection therewith.

F. To deposit, or arrange for the deposit of, securities at Depository Trust Company (DTC) and/or at any other securities depository or clearing corporation.

G. To make any division or distribution in cash or in kind, or partly in cash and partly in kind; to make reasonable valuations of the property so divided or distributed, consistent with the provisions for allocating property to the Marital Trust; and to elect to recognize taxable gain or loss resulting from a distribution. Trustee may consider the income tax basis of the property then available for division or distribution, as well as the circumstances of the beneficiaries, and need not make division or distribution on a pro rata, asset-by-asset basis. Trustee shall not adjust the interest of any beneficiary as a result of any action taken or forborne under the provisions of this Subsection G.

H. To make loans, against adequate collateral, to any person including the Personal Representative of the estate of Trustor or any beneficiary and/or to purchase any property at its then fair market value from any person including such Personal Representative.

I. To borrow money from any person or corporation, including Trustee, and to pledge or mortgage as security any real or personal property.

J. To litigate, submit to arbitration, compromise, or settle any claim in favor of or against any trust hereunder, and to execute all agreements, deeds, and releases necessary or proper in connection therewith.

K. To retain attorneys-at-law, accountants, investment counsel, agents, and other advisers without diminution of compensation otherwise payable to Trustee.

L. To pay the taxes and expenses of maintaining, repairing, improving, and insuring any real property held hereunder.

M. Except as otherwise provided, to determine whether receipts and disbursements, including its commissions, are allocable or chargeable to income or principal. This power shall only be exercised in a manner consistent with the right of Trustor's husband/wife to receive all the net income of the Marital Trust under applicable state law.

N. To receipt for the proceeds of any life insurance made payable to Trustee, to institute any suit or proceedings, and to take any action necessary to collect such proceeds. However, Trustee need not institute any suit or proceeding unless its expenses, including counsel fees and costs, are available in the trust fund or are advanced or guaranteed in an amount and in a manner reasonably satisfactory to it.

O. To renounce, in whole or in part, any property or interest in property which may become payable to any trust hereunder, except to the extent that the distribution of such property resulting from such renunciation is fundamentally inconsistent with the provisions of this agreement.

P. To divide any trust hereunder into separate trusts if the purposes for which the trust was created are better served thereby.

Q. To consider gains from the sale of capital assets in the trust to be part of a mandatory or discretionary distribution of principal to a beneficiary.

#### SECTION 8: INVESTMENT ADVISER.

Trustee shall exercise the powers hereinbefore granted to it in Subsections

A, B, D, E, H, and I of Section 7 with respect to each trust hereunder only on the written direction of the investment adviser of such trust, provided that: (i) Trustee shall manage and invest the otherwise uninvested cash in each such trust in its sole discretion, and (ii) if at any time during the continuance of any such trust there shall be no investment adviser of such trust, or if the investment adviser of such trust shall fail to communicate in writing to Trustee his or her direction as to the exercise of any of the aforesaid powers for which exercise the direction of such adviser shall be necessary, within twenty (20) days after Trustee shall have sent to such adviser, by certified mail (or by any other means for which the sender shall have evidence of receipt by the addressee), at his or her last known address, a written request for such direction (notwithstanding that Trustee shall be under no obligation to request any such direction), then Trustee is hereby authorized and empowered to take such action in the premises as it, in its sole discretion, shall deem to be for the best interest of the beneficiaries of such trust.

The investment adviser of each trust hereunder shall be such one of the following persons, in the order named, as is willing and able to act in such capacity:

Trustor;

Trustor's husband/wife;

The beneficiary for whom the trust was set aside, provided that he/she has attained age twenty-five (25).

To qualify, any person appointed investment adviser of a trust hereunder shall deliver a written instrument to Trustee indicating acceptance and agreement that all powers conferred upon such adviser will be exercised in a fiduciary capacity for the exclusive interest of the beneficiaries.

The investment adviser need not inquire into the Trustee's performance of its duties and shall not be held liable for any loss whatsoever to any trust hereunder, unless it results from actions taken in bad faith. The investment adviser shall serve without compensation, but the investment adviser (other than Trustor) may be reimbursed for out-of-pocket expenses, including investment counsel fees.