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New York Needs a Directed Trust Statute

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Directed trusts have become increasingly popular with clients because of their flexibility. A settlor can direct that one individual, other than the trustee, has certain duties, and parse out responsibilities (and liabilities) as they see fit. This is attractive to some settlors, especially in the context of a closely held business and succession planning. This increasing popularity highlights the need for New York to enact a directed trust statute.

In a prior column,[1] we addressed directed trusts in the broader context of the Uniform Trust Code (UTC) and whether New York should adopt the UTC. For several years, various organizations at the request of the New York State Legislative Advisory Committee on EPTL and SCPA have been considering whether to recommend the adoption of a uniform trust code for New York. Since that last article, the committee has sent its Sixth Report to the New York State Legislature. The Sixth Report recommends that the Legislature enact the UTC, as modified, as a new Article 7-A of the Estate Powers and Trusts Law, and is currently under review.

One area where the Sixth Report modified the UTC language was in the context of directed trusts. The Sixth Report recommended that a modified version of UTC §808 be enacted, instead of the original text. This article explains and reviews directed trusts and the proposed statute, as well as the necessity for the proposed statute to be enacted.

Directed Trusts Explained

In a directed trust the settlor can direct the designation of certain duties, thereby segregating and severing the responsibilities of various parties, as well as their potential liability. This is completely different from delegation regarding investments as provided for under New York's Prudent Investor Act.

For example, a settlor could create a directed trust and name one individual responsible for trust administration, another responsible for investment strategy and/or decisions, and yet a third individual to make distributions. The settlor can direct that the trustee maintain a concentrated stock position, even though it may be prudent to diversify a portfolio. A settlor could also fund a trust with an interest in a closely held business, and then direct the settlor or a specifically named individual to continue managing the business, or otherwise direct a specific succession plan for the business. The settlor could also give family members the power to buy, sell and/or have voting rights on company stock.

Obviously, this flexibility is beneficial to both the settlor and the trustee. The trust instrument could (and should) clearly define the roles and responsibilities of each individual, and clearly delineate and define the potential liability for each party's actions.

A directed trust is different than the situation where a trustee delegates certain trustee responsibilities. A trustee who delegates investment responsibility still has a fiduciary duty (and the corresponding liability) as if he or she directly

managed the investments themselves.

With a power to direct, the trustee usually has no responsibility other than to carry out the direction when made, as well as overall responsibility for seeing that the terms of the trust are honored. A trustee must generally act in accordance with the direction. A trustee may refuse the direction only if the 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.

Current New York Law

Even though there is no current statutory authority in New York for a directed trust, there is case law support. *In Re Rubin*, 143 Misc.2d 303 (Sur.Ct Nassau Co. 1989) (Radigan, S.), discussed a construction proceeding where the executors disputed the validity of a will clause granting specific advisers the power to direct the executors. In reviewing the clause's validity, the court noted that "the earliest common law cases and texts recognize the right of a testator to limit, qualify, or condition the authority granted his fiduciary" which includes "limitations as to time (when the appointment shall begin or end), or place (different executors may be appointed in different geographic areas), or subject matter (one executor may be given exclusive authority over a particular asset or group of assets." Id. at 304-305.

The court also looked to Justice Benjamin Cardozo's statement in *Oliver v. Wells*, 254 N.Y. 451, 459 (1930) that "legacies and devises were acts of bounty merely. The testator was free to withhold them altogether, or subject them to conditions, whether sensible or futile. The gift is to be taken as it is made or not at all."

Following this rationale, the court determined that the clause was valid, and the fiduciary was required to follow the directions of the adviser named within the will. "A grantor or testator may give his gift subject to any terms or conditions he chooses, unless the terms are contrary to public policy or some such restriction applies. Therefore, certain powers can be withheld from the…trustee and delegated to others." *In re Rubin*, at 305-306.

While there is authority for a directed trust, the cases fail to address two important issues: (i) trustee liability for losses resulting from improper investments; and (ii) whether the trustee will incur a reduced trustee fee based upon a limit to his or her role. EPTL 11-2.3(c) is not applicable here because that statute allows trustee investment responsibility to be delegated to another by the trustee and at his or her discretion. EPTL 11-2.3(c) does not apply where the settlor—not the trustee—appoints a directing adviser to handle trust investments, thereby outright relieving the trustee of the responsibility for investment decisions. There are also issues concerning the delegee's submission to the jurisdiction of New York courts.[2]

The Sixth Report

In the Sixth Report, the Advisory Committee referenced and supported a draft of a directed trust statute proposed by the New York State Bar Association.[3]

In the proposal, an "investment advisor" is defined as a fiduciary whose appointment is provided by the terms of the trust instrument, and who has authority to direct investment decisions. "Administrative trustee" is defined as a trustee whose sole responsibility with respect to the investment of trust funds is to follow the written direction of the investment advisor.

The proposal states that any "investment advisor" appointed by the trust document is solely responsible for investing the trust funds by directing the "administrative trustee" in writing as to his or her investment decisions. The administrative trustee "shall comply" with the written directions of the investment advisor. The administrative trustee has no duty to otherwise review the actions of the investment advisor, and is not liable for any losses as long as he or she acts in accordance with the investment advisor's directions. Likewise, the investment advisor is deemed a fiduciary and liable for any loss that results from any breach of this fiduciary duty.

The proposed statute specifies that solely by virtue of accepting the appointment to serve as investment advisor or administrative trustee, they both submit to the jurisdiction of the courts of this state (regardless of the language of the trust agreement) and may be made a party to any action or proceeding relating to those decisions, actions or inactions.

There is also a provision concerning fees which provides that the investment advisor shall be entitled to reasonable compensation, which may be reviewed by the court, while the administrative trustee shall be entitled to either commissions in accordance with section 2312 of the Surrogate's Court Procedure Act or one-half of the commissions provided under section 2309 of the Surrogate's Court Procedure Act.

This proposed statute provides the statutory framework for directed trusts in New York, and also addresses the issues not yet determined by the common law. The Advisory Committee did suggest that any proposal should also consider expanding certain areas of the proposed statute outside of solely the investment context including (i) the ability of the settlor to designate a non-trustee as the person in charge of discretionary distributions; (ii) the inclusion of distribution-related and other powers; and (iii) other tax-related provisions concerning the substitution power under section 675(4)(C) of the Internal Revenue Code of 1986.

The concept of a directed trust conforms to New York's long-standing tenets of trust law. It is a necessary statutory addition so that New York can stay competitive in the trust field.

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Endnotes:

1. C. Raymond Radigan, Peter K. Kelly and Jennifer F. Hillman, "Does New York Need a Trust Code?" New York Law Journal, Jan. 31, 2011.

2. See e.g., *In Re Blumenkrantz*, 14 Misc.3d 462 (Sur.Ct. Nassau Co. 2006) (Riordan, J) where a delegee was not subject to an accounting proceeding because of an arbitration clause within the agreement between the trustee and delegee wherein the trustee delegated its investment function to a delegee.

3. For a more detailed description of the proposed statute and the current New York law on directed trusts, see Natalia Murphy, "Staying Competitive With a Directed Trust Statute: The Proposed Bill for New York," New York State Bar Association Trusts and Estates Law Section Newsletter, Fall 2010 pg. 27-30.

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