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Jane Ditelberg

COMMENTARY AND DIALOGUE

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*Jane Ditelberg**

The Uniform Directed Trust Act[1] adopted by the Uniform Law Commission ("ULC") in 2017 has been enacted in Georgia,[2] Michigan,[3] and New Mexico,[4] and introduced in several other states.[5] Professors Morley and Sitkoff, Chair and Reporter for the UDTA's drafting committee, have written a thoughtful, thorough article reviewing the details of the UDTA and the intent of the drafters[6] as an aid to legislators considering enactment. Their analysis also contains comparisons to other directed trustee statutes pre-dating the Uniform Act.[7] The purpose of this response is to evaluate section 9(b) of the UDTA and to challenge the article's analysis of that provision.

UDTA section 9(b) states as follows:

> A directed trustee must not comply with a trust director's exercise or nonexercise of a power of direction or further power under Section 6(b)(1) to the extent that by complying the trustee would engage in willful misconduct.

Morley and Sitkoff refer to this standard of liability for a directed trustee as both an "innovation"[8] and as the current law in Delaware, Illinois, Texas and Virginia.[9] They describe this as a "diminished" duty for the trustee because the trustee must only "avoid 'willful misconduct'

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1 UNIF. DIRECTED TRUST ACT (UNIF. LAW COMM'N 2017) [hereinafter UDTA].

2 GA. CODE ANN. §§ 53-12-500 to 506 (2018).

3 H.B. 6130, 99th Leg. Reg. Sess. (Mich. 2018), effective Mar. 29, 2019.

4 N.M. STAT. ANN. § 46-14-1 to 18 (2019).

5 As of this printing, Connecticut, Colorado, Nebraska, Rhode Island and Utah are considering adoption. UNIF. LAW COMM'N, *Directed Trust Act*, https://www.uniformlaws.org/committees/community-home?CommunityKey=ca4d8a5a-55d7-4c43-b494-5f8858885dd8.

6 John D. Morley & Robert H. Sitkoff, *Making Directed Trusts Work: The Uniform Directed Trust Act*, 44 ACTEC L.J. 3 (2019).

7 *Id.* at 39-40.

8 *Id.* at 10.

9 *Id*. at 41.

in deciding whether to comply with a director's directions."[10] However they go on to describe the directed trustee as having an added duty, with the result that the aggregated duties of the advisor and the directed trustee exceed those imposed on a non-directed trustee. They describe this as simple and intuitive, and claim it has proven successful and workable in Delaware.[11] The drafters, they report, preferred this approach over the test imposed by statutes in Alaska, Nevada, New Hampshire and South Dakota, which they describe as imposing no liability on a directed trustee for following the advisor's direction, "even if the trustee knows that the [direction] . . . is a breach of the director's duty."[12] They also distinguish the standard under section 808 of the Uniform Trust Code,[13] which they indicate was never under serious consideration.[14]

While the Delaware statute, like the UDTA, uses "willful misconduct" to describe the standard for determining a directed trustee's liability, the rest of the Delaware statute and its definition of willful misconduct differ from section 9(b) of the UDTA. The different wording, definition and interpretation result in a significantly different meaning for those words than the one asserted by Morley and Sitkoff.

Their interpretation hinges on a directed trustee's obligation to evaluate a direction and make a conscious decision whether or not to implement it. They describe the standard for evaluating the direction as whether it would be willful misconduct for the trustee to carry out the direction.[15] This could be interpreted at least two different ways, neither of which is consistent with the existing law the authors describe as the source of this duty.

One interpretation of the phrase "would be willful misconduct for the trustee to carry out the direction" requires the trustee to determine whether, if the trustee made the same decision, such decision would constitute willful misconduct by the trustee. There is no authority in the Delaware statute, or that of any other state, for that standard. This approach forces the trustee to substitute its judgment for that of the advisor and assumes that the trustee will have all the information available to the advisor, which is rarely true with a directed trust.

The other possible interpretation, revealed in Morley's and Sitkoff's example, is that there are some directions that, even if the trustee is not exercising its own will, it is nevertheless willful misconduct for the trustee to follow. Their example is an advisor's direction to sell a

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10 *Id*. at 7.
11 *Id*.
12 *Id*. at 40.
13 UNIF. TRUST CODE § 808, (UNIF. LAW COMM'N 2000), hereinafter "UTC."
14 *See* Morley & Sitkoff, *supra* note 6, at 40.
15 *Id.* at 41-42.

trust asset to the advisor's spouse. Which directions fall into that category is not explained. In addition, the Delaware statute[16] and those of other states imposing a willful misconduct standard expressly relieve a directed trustee of any duty to review the directions received and of any duty to warn a beneficiary when the trustee would have acted differently.[17] Furthermore, this interpretation is inconsistent with the Delaware statute's definition of "willful misconduct."

Delaware Trust Code section 3313(b) 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 wilful 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.[18]

The Delaware statute[19] helpfully defines "willful misconduct:"

> "[W]ilful misconduct" means intentional wrongdoing, not mere negligence, gross negligence or recklessness and "wrongdoing" means malicious conduct or conduct designed to defraud or seek an unconscionable advantage.

Thus in Delaware a directed trustee is not liable "except in cases of willful misconduct *on the part of the fiduciary directed*."[20] Such liability arises out of the specific misconduct of the directed trustee, and not from the contents of the direction or "associative" misconduct in carrying out the direction of an advisor who himself breaches his fiduciary duty. It does not require the directed trustee to evaluate the directions it receives; it requires the directed trustee to avoid its own willful misconduct in implementing the direction.

The Delaware statute also provides,

> [T]he actions of the fiduciary pertaining to matters within the scope of the adviser's authority (such as confirming that the adviser's directions have been carried out and recording and reporting actions taken at the adviser's direction), shall be presumed to be administrative actions taken by the fiduciary solely to allow the fiduciary to perform those duties assigned to the fiduciary under the governing instrument and such administrative actions *shall not be deemed to constitute an undertak-*

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16 DEL. CODE ANN. tit. 12, § 3313(b) (2018).
17 *Id.* § 3313(e).
18 *Id.* § 3313(b) (emphasis added).
19 *Id.* § 3301(h)(4).
20 *Id.* § 3313(b).

> *ing by the fiduciary to monitor the adviser or otherwise participate in actions within the scope of the adviser's authority*.[21]

The article describes UDTA section 9(b) as imposing the usual fiduciary duties on the advisor and an additional duty on the directed trustee "to avoid willful misconduct"[22] which by virtue of their example refers to willful misconduct on the part of the advisor, that is to say the advisor's direction to gain an unconscionable advantage by selling trust property to the advisor's spouse.[23] The language of the Delaware statute refutes any assertion that the UDTA, as interpreted in the article, reflects Delaware law.

The Illinois statue, also cited in the article in support of the willful misconduct standard, stands in even starker contrast:

> if a governing instrument provides that an excluded fiduciary is to follow the direction of a directing party, and such excluded fiduciary acts in accordance with such a direction, then except in cases of willful misconduct on the part of the excluded fiduciary *in complying with the direction of the directing party*, the excluded fiduciary is not liable for any loss resulting directly or indirectly from following any such direction . . . .[24]

The growing body of case law on directed trusts supports this interpretation of the pre-UDTA directed trust statutes, and the courts have, in nearly all cases,[25] specifically declined to impose a duty on the directed trustee to review, monitor, or evaluate the advisor's directions.[26]

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21 *Id.* § 3313(e) (emphasis added).

22 Morley & Sitkoff, *supra* note 6, at 42.

23 *Id.* at 40.

24 760 ILL. COMP. STAT. 5/16.3(f)(1) (2015) (emphasis added). The other statutes cited in support of Morley and Sitkoff's interpretation of the willful misconduct standard are similar. See, e.g., the Virginia Trust Code, which refers to "willful misconduct or gross negligence *on the part of the directed trustee*," VA. CODE ANN. § 64.2-770(E)(2) (2014) (emphasis added); *see also* TEX. PROP. CODE ANN. § 114.0031(f)-(g) (West 2015).

25 The exception is *Rollins v. Branch Banking & Trust Co.,* 56 Va. Cir. 147 (2001), where the court concluded that the directed trustee was not liable for the investment decisions of the advisor but did have, under common law, a duty to warn the beneficiaries. Since most directed trust statutes expressly eliminate a duty to warn, this case may no longer be relevant.

26 Duemler v. Wilmington Tr. Co., No. 20033 NC, 2004 WL 5383502 (Del Ch. Oct. 22, 2004); Shelton v. Tamposi, 62 A.3d 741 (N.H. 2013). *See also* Peter S. Gordon & Michael M. Gordon, *Why is Everyone Talking About Delaware Trusts*, https://www.gfmlaw.com/sites/default/files/pdfs/Why%20is%20Everyone%20Talking%20About%20Delaware%20Trusts.pdf, at 38-39 (2016) (discussing Friedman v. U.S. Tr. Co. of Del., C.A. No. 20205 NC (Del. Ch. 2003)).

These statutes[27] focus on the potential willful misconduct of a directed trustee in implementing directions. Although the authors claim the drafters of the UDTA incorporate the same standard, they have in fact turned it on its head. No law is cited by them as the source of the directed trustee's duty to evaluate the direction and determine (a) whether it would be willful misconduct if the directed trustee itself were to have taken the action directed, or (b) if the direction constitutes the advisor's willful misconduct. Morley's and Sitkoff's effort to equate the UDTA provision to existing directed trust statues is inapt, and legislators considering enactment need to understand the distinction and its consequences for grantors, directing parties, and directed trustees.

What should a directed trustee do upon receipt of a direction to sell an asset to the advisor's spouse? Under the Illinois and Delaware statutes, the answer is clear: carry out the sale. The trustee would be liable for a loss if through willful misconduct the trustee failed to sell the asset, sold the wrong asset, or failed to consummate the sale on the terms the advisor directed. But if the decision of the advisor is carried out, the consequences of the decision are, and should be, the responsibility of the advisor whether the decision is simply poor investment advice or constitutes misconduct by the advisor (*e.g.* the sale to the spouse is at a price or on terms disadvantageous to the trust). If those acts are misconduct, they are the misconduct of the advisor.

The directed trustee under the UDTA, however, faces a different calculus. According to Morley and Sitkoff, the drafters of the UDTA intended to impose a new duty on directed trustees to disregard certain directions, but were silent on which ones to disregard. That trustee must determine whether following the direction "would be willful misconduct" by the trustee. Does this decision rest on whether it would be willful misconduct if the trustee made the same decision? On whether it would be willful misconduct if the trustee made the same decision, under the same circumstances (i.e. its own conflict of interest), even if those circumstances do not apply to the directed trustee? And how, if it has no duty to review, will the trustee know that the terms are disadvantageous? A direction to sell asset A to person B does not on its face reveal that B is the advisor's spouse, or whether the sale is occurring with the consent of the beneficiaries, or is pursuant to a pre-existing option agreement. Perhaps there is no other buyer, and the sale of the asset is necessary to diversify the portfolio, to generate income, or to provide liquidity for tax payments. The fiduciary making the decision (the advisor) needs to consider all of these issues which will not be apparent to a directed trustee. And under the existing statutes it is clear

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27 *See* DEL. CODE ANN. tit. 12, § 3313(b) (2018); 760 ILL. COMP. STAT. 5/16.3(f)(1); TEX. PROP. CODE ANN. § 114.0031(f)-(g); VA. CODE ANN. § 64.2-770(E)(2).

that the trustee does not have a duty to second-guess this decision, or to make its own separate evaluation of these factors.

Calling the UDTA's standard a "*willful* misconduct" standard is a misnomer. What does willful mean in this context? According to Black's, the definition of willful is, "voluntary and intentional, but not necessarily malicious."[28] In a directed trust, the only party who has a design or intention with respect to the directed action is the advisor. In Morley's and Sitkoff's example (selling trust property to the advisor's spouse), any "malicious" intent belongs to the advisor, not the trustee.

The directed trustee is appointed by a grantor not to opine but to accede to the advisor's decision. The bifurcation of duties is often intended to enable the advisor to direct actions the trustee would not itself take. Grantors may expect advisors to approve retention of investment concentrations, favor one group of beneficiaries over another in making distributions, or invest in assets about which the directed trustee lacks expertise. The purpose of a directed trust is undermined if the trustee, to avoid liability, must substitute its own judgment for the advisor's.

Morley and Sitkoff note that states enacting the UDTA may want to choose a different standard of liability.[29] They suggest that the other option is to provide that the directed trustee is never liable for directed actions. The choice is not so starkly binary; in addition to the actual Delaware approach is the one described below.

In my view, there are some actions that a trustee, directed or not, cannot take under any circumstances because they are unlawful. Examples of such actions include money laundering, violating currency restrictions, engaging in fraud, or making material misrepresentations. The trustee should be prohibited from implementing these directions, not because of the willful misconduct of the advisor, and not because it would be willful misconduct if the trustee made the same decision, but because the directed trustee should not knowingly violate applicable laws. And no grantor or advisor should expect a trustee, directed or not, to behave otherwise.

UDTA section 9(b) could be revised to focus on the lawfulness of the direction:

> A directed trustee must not comply with a trust director's exercise or nonexercise of a power of direction or further power under Section 6(b)(1) to the extent that ~~by complying the trustee would engage in willful misconduct~~ the directed trustee is thereby directed to knowingly violate the laws or regulations of any jurisdiction applicable to the trust. For purposes of this sec-

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28 *Willful*, BLACK'S LAW DICTIONARY (10th ed. 2014).

29 Morley & Sitkoff, *supra* note 6, at 32.

> tion, "knowingly" shall mean "known by the trustee based upon the contents of the direction and any information provided by the trust director therewith." The directed trustee may reasonably rely upon advice of legal counsel to determine what actions would be consistent with or contrary to applicable law. Reasonable expenses incurred by the directed trustee in good faith for legal review of an instruction from a directing party or a petition for judicial instructions regarding its authority to comply with a direction shall be proper expenses of the trust.

The standard of liability under section 9(b) of the UDTA is not only inconsistent with the law in Delaware and other jurisdictions but represents a shift in responsibility from the advisor (chosen by the grantor to act) to the directed trustee. Legislators adopting the UDTA should consider what standard of liability best enables the fiduciaries of a directed trust to carry out the grantor's intent that responsibilities be bifurcated and fairly allocates liability for decisions to the party making the decision, rather than the one implementing it.