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# From Strength to Strength: A Comment on Morley and Sitkoff's *Making Directed Trusts Work*

James P. Spica\*

## I. INTRODUCTION

Accessory to Professors Morley and Sitkoff's admirable outline of the Uniform Directed Trust Act (UDTA),<sup>1</sup> this Comment describes two ways in which a state that has been forward to adopt the UDTA, *viz.* Michigan,<sup>2</sup> has modified the act *en route*.<sup>3</sup> These modifications operate in disparate parts of the act: one limits the circumstances in which a trustee subject to direction can be liable to trust beneficiaries for doing as directed; the other limits the class of persons eligible to direct. But both strengthen the same, signal virtue of the UDTA, which is that the act increases a settlor's ability to insulate a "directed trustee" from liability for following improvident directions.<sup>4</sup>

## II. MARKET INCENTIVES FOR PRICE DIFFERENTIATION

That is a virtue because it allows professional trustees to take the settlor's division of administrative labor seriously as a scheme of fiduciary-risk allocation at a time when professional trust-service providers are increasingly being asked by settlors to reduce their standard fees in light of allocations of administrative responsibilities to holders of powers to direct: the settlor reasons that the power holder will assume responsibility for the directed function and that, because following directions is less onerous than exercising discretion, the directed professional trustee's standard fee should be adjusted.

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<sup>1</sup> John D. Morley & Robert H. Sitkoff, *Making Directed Trusts Work: The Uniform Directed Trust Act*, 44 ACTEC L.J. 3 (2019).

<sup>2</sup> See 2018 Mich. Pub. Act Nos. 663, 664 (effective Mar. 29, 2019).

<sup>3</sup> For a fuller account of Michigan's modifications of the UDTA, see James P. Spica, *Used Not Only as Directed: Michigan's Adaptation of the Uniform Directed Trust Act*, 64 WAYNE L. REV. 339, 390-99 (2019).

<sup>4</sup> See *infra* notes 7-10 and accompanying text.

But *is* following directions less onerous than exercising discretion? The professional trustee will evaluate whether to cut her standard fee in this situation by asking in what circumstances she can be liable for doing what the settlor would have her do—*follow directions*. To the extent following a direction from a power holder when the power holder is acting within her authority under the terms of the trust will effectively insulate the trustee from liability, the trustee can take the settlor’s division of administrative labor seriously as a scheme of fiduciary-risk allocation. But to the extent the trustee can be liable to beneficiaries for doing exactly as directed when the power holder is acting within her authority, the request that the trustee reduce her professional fee is a request that she forgo compensation for risk or, equivalently, for effort she will have to mount—in the way of vigilance over the power holder—to avoid risk.

### III. FIDUCIARY RISK

At common law and under the Uniform Trust Code, a trustee has an ineradicable duty to balk at a direction, even if the direction is formally within the director’s authority under the terms of the trust, if the trustee has reason to know that the direction so contravenes the purposes of the trust or interests of trust beneficiaries as to constitute an abuse.<sup>5</sup> The UDTA changes that,<sup>6</sup> and so does Michigan’s version of the UDTA (MUDTA),<sup>7</sup> but not in the same way. Under the default rules of the MUDTA,<sup>8</sup> if an exercise or nonexercise of a power of direction that is within the power holder’s authority under the terms of the trust turns out to be improvident, a directed trustee can only be liable for complying “if the exercise or nonexercise was obtained with the directed trustee’s collusion or by the directed trustee’s fraud.”<sup>9</sup> The standard under the default rules of the UDTA is different:

[A] directed trustee shall take reasonable action to comply with a trust director’s exercise or nonexercise of a power of direction . . . and the trustee is not liable for the action [provided, however, that] [a] directed trustee must not comply with

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<sup>5</sup> See RESTATEMENT (THIRD) OF TRUSTS § 75 cmt. d (AM. LAW INST. 2003); UNIF. TRUST CODE § 105(b)(2) (UNIF. LAW COMM’N 2010) (enacted in Michigan as MICH. COMP. LAWS § 700.7105(2)(b) (2018)).

<sup>6</sup> See UNIF. DIRECTED TRUST ACT § 9 legislative note (UNIF. LAW COMM’N 2017).

<sup>7</sup> See MICH. COMP. LAWS § 700.7105(2)(b) (2019).

<sup>8</sup> The standards for directed-trustee liability set by the UDTA and the MUDTA are *minimum* standards: the settlor is free under both regimes to require more of a directed trustee than is required by the default rules. See UNIF. DIRECTED TRUST ACT § 9(e); MICH. COMP. LAWS § 700.7105(1) (based on UNIF. TRUST CODE § 105(a)).

<sup>9</sup> MICH. COMP. LAWS § 700.7703a(7).

a trust director's exercise or nonexercise of a power of direction . . . to the extent that *by complying the trustee would engage in willful misconduct*.<sup>10</sup>

The ULC Comment to the provision just quoted makes it clear that conduct sufficient to trigger directed-trustee liability under the UDTA's willful-misconduct standard may consist entirely *in complying with* a sufficiently egregious exercise or nonexercise of a power of direction:

[B]ecause a trustee stands at the center of a trust, the trustee must bear at least some duty even if the trustee is acting under the direction of a director. Although the settlor could have made the trust director the sole trustee, the settlor did not actually do so—and under traditional understandings of trust law, *a trustee must always be accountable to a beneficiary in some way*.<sup>11</sup>

The UDTA's willful-misconduct standard thus makes a stark contrast to the MUDTA's collusion-or-fraud-in-obtaining-exercise-or-nonexercise standard: under the uniform act, the quality of a particular exercise or nonexercise of a power of direction can determine whether a directed trustee may be liable to trust beneficiaries for complying; whereas under the default rules of the MUDTA, following a direction that was not *procured* by the directed trustee's own affirmative misconduct will never in itself expose a directed trustee to liability for breach of trust.<sup>12</sup> Under both the UDTA and the MUDTA, a directed trustee is free to question (and convey her reservations regarding) the appropriateness of a particular exercise or nonexercise of a power<sup>13</sup> and she can seek a court order directing her to comply, temporize, or resist.<sup>14</sup> The difference is that under the default rules of the UDTA, but *not* those of the MUDTA, a trustee may be liable for *failing* to do one or more of those things based on a claim that the exercise or nonexercise in question is such that merely *by complying* the trustee engaged in willful misconduct.<sup>15</sup>

But when is the exercise or nonexercise of a power of direction such that mere compliance will involve a directed trustee in willful misconduct? We learn from a ULC Comment that a trust director's unreasonableness in the exercise or nonexercise of a power is not in itself

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<sup>10</sup> See UNIF. DIRECTED TRUST ACT § 9(a)–(b) (emphasis added).

<sup>11</sup> See *id.* § 9(a)–(b) cmt. b (emphasis added).

<sup>12</sup> See *supra* note 9 and accompanying text.

<sup>13</sup> See UNIF. DIRECTED TRUST ACT § 11(a)(2) (UNIF. LAW COMM'N 2017); MICH. COMP. LAWS § 700.7703a(11)–(12) (2019).

<sup>14</sup> See UNIF. DIRECTED TRUST ACT § 9(d); MICH. COMP. LAWS §§ 700.1302(b)(vi), 700.7203(1).

<sup>15</sup> See *supra* notes 10–11 and accompanying text.

sufficient to condemn compliance.<sup>16</sup> So, we have to ask what it is *in addition to* or, perhaps, *apart from* unreasonableness that will so mar a trust director's exercise or nonexercise of a power as to proclaim a responsive trustee's obedience "willful misconduct." One searches the UDTA and the ULC Comments in vain for an answer.

Morley and Sitkoff have given an account of that lack of guidance that will hardly reassure the professional trustee who is being asked to reduce her standard fee in light the settlor's allocation of administrative responsibilities to trust directors: the ULC drafting committee, they tell us, "decided to preserve room for judges to elaborate the willful misconduct standard in application."<sup>17</sup> To that extent, the MUDTA must compare favorably with the uniform act as an inducement for the professional trustee to credit the settlor's division of administrative labor as a scheme of fiduciary-risk allocation; for the UDTA is designedly vague as to the circumstances in which a directed trustee can be liable to trust beneficiaries for doing exactly as directed by a trust director who is acting within her authority under the trust instrument.

#### IV. STATE REGULATION OF ENTITY TRUST POWERS

The UDTA counterpoises increasing the settlor's ability to insulate directed trustees from liability with conservation of *aggregate* fiduciary responsibility: by assimilating trust directors to trustees for purposes of imposing duties and liabilities on such directors,<sup>18</sup> the UDTA ensures that the beneficiaries of a trust are always owed at least the fiduciary duties they would be owed if the trust in question made no provision for a trust director.<sup>19</sup> But the practical value of that assurance is liable to be affected by the sorts of persons permitted to act as trust directors; it is liable to be *depreciated* if the UDTA allows, for example, a thinly capitalized limited liability company to be created for the purpose of accepting a trust directorship in a state in which, but for enactment of the UDTA, such a company would not be permitted to exercise the relevant powers of direction.

Other than natural persons, the only persons permitted to exercise trust powers in Michigan are corporations authorized to do so in one of several ways enumerated in the Michigan Banking Code.<sup>20</sup> One way, the catch-all, is for "[a] nonbanking corporation [to] be specifically authorized to act as fiduciary in [Michigan] by another statute of [Michi-

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<sup>16</sup> See UNIF. DIRECTED TRUST ACT § 9 cmt. a.

<sup>17</sup> See Morley & Sitkoff, *supra* note 1, at 43.

<sup>18</sup> See, e.g., UNIF. DIRECTED TRUST ACT §§ 8(a), 16; MICH. COMP. LAWS § 700.7703a(5), (21).

<sup>19</sup> See UNIF. DIRECTED TRUST ACT prefatory note (UNIF. LAW COMM'N 2017).

<sup>20</sup> See MICH. COMP. LAWS § 487.11105(2) (2018).

gan].”<sup>21</sup> Now, the UDTA (1) permits a settlor to “grant a power of direction to a trust director,”<sup>22</sup> (2) subjects “trust directors” to personal jurisdiction<sup>23</sup> and to “fiduciary dut[ies]” in respect of their “powers of direction,”<sup>24</sup> (3) defines “trust director” as a “*person* . . . granted a power of direction,”<sup>25</sup> and (4) defines “person” to include legal entities such as corporations.<sup>26</sup> Thus, wholesale adoption of the UDTA in Michigan could have been interpreted as authorizing nonbanking organizations to exercise trust powers pursuant to the terms of trusts granting powers of direction.<sup>27</sup>

In Michigan, that interpretation could have affected the process of enactment; for the Michigan Constitution requires a supermajority in both houses of the State legislature for the enactment of any “general law providing for the incorporation of trust companies or . . . regulating the business thereof.”<sup>28</sup> But the interpretation also threatens, in the way suggested above, the practical significance of conservation of aggregate fiduciary responsibility. For that reason (as well as the possible constitutional complication), the MUDTA limits the entities to which a settlor may grant powers of direction to those *otherwise* authorized by Michigan law to act as trustees: “‘Trust director’ means an organization permitted to exercise trust powers in this state as described in section 1105(2) of the Banking Code of 1999, 1999 PA 276, or an individual, if that person is granted a power of direction . . . .”<sup>29</sup>

## V. CONCLUSION

That limitation strengthens the principle of conservation of aggregate fiduciary responsibility as internal support for allowing settlors to insulate directed trustees from liability for following directions. And by clarifying—and presumably *increasing*—the maximum protection settlors can provide against such liability, the MUDTA’s collusion-or-fraud-in-obtaining-exercise-or-nonexercise standard strengthens the act’s inducement for professional trust-service providers to credit settlors’ divisions of administrative labor as schemes of fiduciary-risk allocation and to assess market incentives for price differentiation

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<sup>21</sup> See *id.* § 487.11105(2)(e).

<sup>22</sup> UNIF. DIRECTED TRUST ACT § 6(a) (and MICH. COMP. LAWS § 700.7703a(3)).

<sup>23</sup> See *id.* § 15 (and MICH. COMP. LAWS § 700.7703a(20)).

<sup>24</sup> See *id.* § 8(a) (and MICH. COMP. LAWS § 700.7703a(5)).

<sup>25</sup> See *id.* § 2(9) (and MICH. COMP. LAWS § 700.7703a(24)(f)) (emphasis added).

<sup>26</sup> See *id.* § 2(4) (and MICH. COMP. LAWS § 700.1106(n) (defining “person” to include individuals and organizations)).

<sup>27</sup> See MICH. COMP. LAWS § 487.11105(2) (2018).

<sup>28</sup> MICH. CONST. art. IV, § 43 (1963).

<sup>29</sup> MICH. COMP. LAWS § 700.7703a(24)(f); see also *id.* § 700.1106(n) (defining “person”).

accordingly. Thus, both of the modifications we have described here can be viewed—as they have been viewed in Michigan—as adding strength to the UDTA’s strength.