

## **Directed Trustees in Texas – New Section 114.0031**

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### **Collin County Bar Association Estate Planning/Probate Section**

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## I. Introduction

As estate planning has become more complex and the use of trusts for multi-generational planning by families has grown more widespread, the traditional roles and responsibilities of trustees have evolved. Historically, one trustee was responsible for everything for the trust: taxes, recordkeeping, distributions, and investment decisions. Over the last 30 years, trust law has progressed such that, in many states, the settlor of the trust may delegate sole responsibility for investment and other decisions to third parties--for example, an investment or distribution advisor.

The ability to delegate this type of authority is recognition that the trustee may not have the expertise to make certain decisions designed to bring the greatest benefit for the trust and its beneficiaries. Importantly, a family may have many different types of assets--real estate, oil and gas, ranches, and family owned businesses--and the settlor might want to name a more sophisticated individual or firm to handle these investments. Similarly, a close family friend may be much more knowledgeable about the specific needs of the beneficiaries of the family trusts.

Prior to 2015, Texas law provided that the terms of a trust could give an advisor the power to direct certain actions of the trustee. The statute required that "the trustee shall act in accordance with the person's direction unless: (1) the direction is manifestly contrary to the terms of the trust; or (2) the trustee knows the direction would constitute a serious breach of a fiduciary duty that the person holding the power to direct owes to the beneficiaries of the trust." That statute essentially forced a trustee to second-guess and have an undefined liability for the actions of the directing advisor, even if the trustee had no experience in those matters.

At that time, twenty states and Delaware (1986) allowed a trustee to follow without liability the directions of an advisor unless there was wilful misconduct or other similar protective standard. The result was a more flexible and logical approach for settlors of trusts. An added benefit in these states was that corporate trustees could charge significantly lower fees because a substantial amount of their responsibilities and management could be lifted from their shoulders. Especially in larger situations, trusts were going to other states to be administered and were permanently leaving Texas.

Both estate planning attorneys and professional trustees agreed that the statute was not workable and that a significant amount of trust business had left Texas as a result. Both the Texas Bankers Association's Wealth Management and Trust Division

and the Texas Bar Association's Real Estate, Probate and Trust Law Committee proposed legislation to modernize the pre-2015 statute. The versions were different. The Texas Banker's version was closely modeled on Delaware Section 3313, Title 12. That version, House Bill 3190, was introduced by State Representative Jason Villalba, co-sponsored by Senator Don Huffines, and passed the legislature. Governor Abbott signed the bill, and it became effective on June 19, 2015.

Most recently, the Uniform Law Commission Drafting Committee For An Act on Directed Trusts, in its overview memorandum, 5/23/2016, p.3, adopted this limited liability approach because the Committee believed it provides some protection for beneficiaries and seemed to have received widespread support given the number of the directed trusts being created in Delaware.

For this outline, the "directed trustee" is referred to as the administrative trustee; others have called that trustee the general or custodial trustee. In a directed trust, the settlor of the trust names one or more advisors with powers over investments, distributions or other trustee matters. They can direct the administrative trustee to take specific actions and the administrative trustee must follow those, bearing no liability for carrying out those instructions, absent wilful misconduct. Advisors can also be trust protectors. Presumably, a power to direct can be still be placed with a co-trustee.

## **II. Significant Provisions of Section 114.0031**

### **a. The new changes do not apply to charitable trusts, Section 114.0031(b):**

The Texas attorney general had two concerns. First, with the powers that an advisor could have, a charitable trust could be substantially modified without the review or consent of the attorney general. Second, since an advisor could act in a non-fiduciary capacity, the attorney general felt that there might not be an identifiable, legally responsible party, which he could take action against to protect the public interest in the charity. Thus, charitable trusts were excluded from the changes and remain covered by Section 114.003.

### **b. Advisors and trust protectors, Section 114.0031(a):**

“Advisor’ includes protector.”

c. Powers and liabilities, Sections 114.0031(d) and (e):

“the power to remove and appoint trustees, advisors, trust committee members, and other protectors;

the power to modify or amend the trust terms to achieve favorable tax status or to facilitate the efficient administration of the trust; and

the power to modify, expand, or restrict the terms of a power of appointment granted to a beneficiary by the trust terms.

If the terms of a trust give a person the authority to direct, consent to, or disapprove a trustee's actual or proposed investment decisions, distribution decisions, or other decisions, the person is considered to be an advisor and a fiduciary when exercising that authority except that the trust terms may provide that an advisor acts in a non-fiduciary capacity.”

d. Administrative trustee’s responsibilities and liabilities, Sections 114.0031(f) and (g):

“A trustee who acts in accordance with the direction of an advisor, as prescribed by the trust terms, is not liable, except in cases of wilful misconduct on the part of the trustee so directed, for any loss resulting directly or indirectly from that act.

If the trust terms provide that a trustee must make decisions with the consent of an advisor, the trustee is not liable, except in cases of wilful misconduct or gross negligence on the part of the trustee, for any loss resulting directly or indirectly from any act taken or not taken as a result of the advisor's failure to provide the required consent after having been requested to do so by the trustee.”

e. Administrative trustee’s responsibility to monitor, Section 114.0031(h):

“If the trust terms provide that a trustee must act in accordance with the direction of an advisor with respect to investment decisions, distribution decisions, or other decisions of the trustee, the trustee does not, except to the extent the trust terms provide otherwise, have the duty to:

(1) monitor the conduct of the advisor;

(2) provide advice to the advisor or consult with the advisor; or

(3) communicate with or warn or apprise any beneficiary or third party concerning instances in which the trustee would or might have exercised the

trustee's own discretion in a manner different from the manner directed by the advisor.”

- f. Liability standard for the administrative trustee’s actions, Section 114.0031(i):

“Absent clear and convincing evidence to the contrary, the actions of a trustee pertaining to matters within the scope of the advisor's authority, such as confirming that the advisor's directions have been carried out and recording and reporting actions taken at the advisor's direction, are presumed to be administrative actions taken by the trustee solely to allow the trustee to perform those duties assigned to the trustee under the trust terms, and such administrative actions are not considered to constitute an undertaking by the trustee to monitor the advisor or otherwise participate in actions within the scope of the advisor's authority.”

### **III. Types of Direction**

Many types of direction can be included in a trust. The list of powers in the statute is non-exclusive. A few of the most important are listed below. In addition, since Section 114.0031(e) provides that the trust terms may state that the directing party can act without fiduciary liability, the drafting attorney and the client settlor must consider whether or for which power fiduciary liability should apply. Other than for broad investment powers, arguably fiduciary liability should not apply. If fiduciary liability does not apply, what other standard should be used?

- a. Investments

This power can be very broad or limited to a special asset or specific actions, i.e., choose or replace board members for the Family LLC. If the powers are very broad, perhaps fiduciary liability should apply. If powers are limited, as in replacing board members or selling the family ranch, perhaps a lesser standard makes more sense.

- b. Distributions

Typically, this will be someone who is close to the beneficiary and is best able to assess the beneficiary’s needs. This might be especially appropriate for a beneficiary with special needs or a trust with incentives or other requirements that require close supervision or awareness of the beneficiary’s lifestyle or medical condition. If this is a second marriage situation and the surviving spouse of the second marriage is the trustee, a distribution trustee as to the children of the first marriage might likewise be helpful.

c. Power to change situs or governing law

This power could be important if beneficiaries move, state income tax law changes, decanting or perhaps spendthrift protection is more favorable in another state.

d. Tax decisions

An entire paper could be written on this subject if the advisor is a family member or related party as defined by the Internal Revenue Code. A “tax swap” power should not be held in a fiduciary capacity. A savings clause should be included to avoid any inadvertent adverse consequences.

e. Power to modify a power of appointment

While this power might have important tax implications (converting a limited power of appointment to a general power to get a step-up in basis), there may be other stewardship or family reasons to modify.

f. Trust termination

This can be very significant whether for tax purposes (to get a step-up in basis) or the number of beneficiaries has grown too large to justify economically the existence of the trust. Termination could be all or in part.

g. Powers of Protection

These might include powers to allow standing to give instructions, interpret the trust, resolve differences between trustees, beneficiaries or investment advisors, determine capacity of the trustee, beneficiary or other advisors, or to prosecute, defend, or join an action, claim or judicial proceeding.

#### **IV. Litigation**

Very few reported cases on the subject.

a. R. Leigh Duemler v. Wilmington Trust Company,  
C.A. 20033, (Del. Ch. Oct. 28, 2004)

Mr. Duemler was the investment advisor of a trust with the express power under the trust instrument to direct Wilmington Trust Company, as the trustee of the trust, with respect to all investments. The Court held that Section 3313 requires the investment advisor to make investment decisions in isolation, without oversight from the trustee, because if the investment advisor did not make the investment

decisions alone, the investment advisor's role would not work as the trustee would always have to "second guess" the investment advisor's decisions. Finding that Wilmington Trust Company did not engage in willful misconduct, the Court upheld a statutory defense under Section 3313 which provides that when a trust instrument provides that a trustee shall act at the direction of an advisor with respect to investments and other decisions, then, except in cases of willful misconduct, the trustee shall not be liable for any loss resulting from any such act. The Court explained that if the trustee were liable in such situations for "the failure to provide information or to make sure that [the investment adviser] making the decision knew what they were doing it would "gut the statute".

b. In Rollins v. Branch Banking and Trust Company of Virginia, 56 Va. Cir. 147, 2001 W.L. 34037931 (Va. Cir. Ct., 2002)

The court acknowledged that, as a matter of Virginia state law, it was the duty of the directed trustee of a trust to follow the instructions of the trust's beneficiaries regarding a closely held family business. Apparently, there was an agreement with them when the trust was created. Catastrophic losses were suffered. The court held that there was no liability on the part of the directed trustee, BB&T, for holding the stock. However the court said that common law continued to impose upon the trustee a duty to keep itself informed as to the conditions of the trust and an unavoidable "duty to warn" beneficiaries. The Rollins case was settled after the decision, so it is not clear if the bank would have appealed the duty to warn, which seems not to be in keeping with the rest of the court's reading of the statute.

In 2012, Virginia amended their directed trustee statute, closely following Delaware, so that trustees would seemingly no longer have the duty to keep the beneficiaries so informed if the trust did not require it.

c. Mennen v. Wilmington Trust Company, C.A. No. 8432-ML (April 24, 2015)

This 89-page opinion contains multiple trust issues. Wilmington Trust was the directed trustee; a co-trustee had the ability to direct investments. The results again were disastrous. The court stated that, as to one of the issues, investment direction, the trustees would be exculpated if they did not act in bad faith or with wilful misconduct. However, the court left open the issue of wilful misconduct for the jury. Wilmington Trust settled the day before the trial. A judgment of over \$72 million dollars was entered against the individual co-trustee with the power of direction.

d. Shelton v. Tamposi, 62 A. 3d 741 (N. H. 2013)

In this case, the investment advisors with a power of direction invested in real estate. The administrative trustee felt that the cash flow was insufficient to meet the needs of the beneficiaries and requested higher levels of distributions from the real estate investments. When they refused, the administrative trustee asked the court for an order that her powers of distribution were superior to the powers of the investment advisors and that she had to power to require higher cash distributions.

The New Hampshire Supreme Court ruled that, taking into consideration the language of the powers of direction in the Trust (which were extensive), the investment advisors had complete and unfettered control over the cash flows in their investment vehicles and that the administrative trustee could only make decisions on distributions under the language of the trust after the trustee received the cash. Thus, the authority of the administrative trustee was subordinate to the investment advisors.

**V. Drafting Issues**

Additional advisors and directors create more complexity and administrative expenses. While these players may solve issues and provide benefits to the beneficiaries, the drafting must be very clear in separating the roles and responsibilities. To do otherwise may create confusion and inadvertently raise costs through seeking clarity thru the courts or long, drawn-out litigation between the various parties. The drafting attorney should not hesitate to take as many pages as necessary to provide certainty.

- a. The individual or entity named to provide direction should either be specifically assigned fiduciary liability or not. If the settlor wants fiduciary liability for the tasks assigned, the settlor must consider whether the advisor will accept the position, understanding the potential liability and whether the advisor will have sufficient deep pockets if the trust is damaged through his misconduct.
- b. If the advisor is a family member or a “related party” as defined by the tax code, careful consideration should be given to potential tax issues--income and estate--that might arise through the exercise or potential exercise of that power.
- c. Since individuals and corporate entities do not live or remain competent or intact forever, consideration needs to be given to how advisors can resign, are succeeded, are appointed, and whether they will be excluded from liability for the acts of their predecessors (no duty to review, investigate or remedy, etc.). Importantly, if or while there is a vacancy, who makes decisions?



- d. All directions should be required in writing with reasonable time limits for directing and executing.

***Document, document, document.***

- e. The directing advisor should be required to give the administrative trustee sufficient information about transactions and values of non-publicly traded investments so that the administrative trustee can properly report to the beneficiaries on a timely basis. Similarly, the administrative trustee should be required to give the investment advisor information on potential needs for beneficiary distributions, taxes and fees.
- f. Since the directed trustee statute is a state law creation, it will not necessarily protect a directed trustee from claims arising under federal law or that are against public policy.
- g. While Texas Statute 114.0031(h) is very clear that the administrative trustee has no duty to monitor or inform, the few cases that have arisen with directed trustee statutes also allege a common law duty to inform. Plaintiffs seemingly get leeway from the judges when this has not been clearly spelled out.
- h. If the investments are complex and require special knowledge or experience, define how reasonable compensation for the advisor is to be evaluated.
- i. Consider whether the power to direct should be in one person or in a committee.
- j. For directed powers that are assigned fiduciary liability, the administrative trustee would be well served to have something in writing from the directing advisor or protector that they accept the fiduciary liability.
- k. The power to remove or appoint an investment advisor should reside in a trust protector, not in the administrative trustee.

**VI. Open Questions**

Wilful misconduct is not defined in the Texas Trust Code. Delaware, Section 3301(g), defines it as “intentional wrongdoing, not mere negligence, gross negligence or recklessness and ‘wrongdoing’ means malicious conduct or conduct designed to defraud or seek an unconscionable advantage.” Texas courts in cases regarding business law questions often look to Delaware for interpretation. Interestingly, the Uniform Law Commission Drafting Committee for the Act for “Divided Trustees”

used “willful misconduct” and, in their explanatory notes, cite Delaware in their latest proposed draft (April 1-2, 2016).

A question has been raised as to whether the individual with the power of direction must have fiduciary liability under the trust’s terms. The Uniform Law Commission drafters require fiduciary liability for some directions but not for others (Draft of Directed Trust Act submitted for the Annual Meeting, July 8-14, 2016). Beyond the specific matters that the drafters address, the scope of potential direction is very broad and it would seem too complex to say as a matter of statute when fiduciary liability should or should not apply. Should it rather depend on the nature of the direction or, simply, leave it to the settlor to make the decision. Perhaps, the trust terms should provide that an individual with a power of direction has a duty to the trust beneficiaries, but it may not be necessary that it always rise to the level of fiduciary liability.

Matthew McClintock, Vice President of Education at WealthCounsel LLC, Leimberg Estate Planning Newsletter #2439 (July 21, 2016) goes thru an extensive list of powers that might or might not be considered fiduciary in nature. As to case law, Alexander Bove, a Boston attorney, who has lectured and written extensively on a wide variety of trust topics, in a recent Leimberg Estate Planning Newsletter, #2432 (June 30, 2016), wrote that to date there are no cases in the United States commenting on whether a trust protector is a fiduciary.

## **VII. Further Research**

Rosenblatt and Buckner, “A Rose by Any Other Name: Utilizing And Drafting Powers for Trustees, Trustee Advisors, and Trust Protectors,” State Bar of Texas 25<sup>th</sup> Annual Estate Planning and Probate Drafting Course (October, 2014).

Lindquist, “Drafting Fiduciary Powers For Trust Protectors and Independent Trustees,” State Bar of Texas Annual Estate Planning and Probate Drafting Course (October, 2015).

Lovelace and Karisch, “Trust Protectors (Trust Advocates),” 17<sup>th</sup> Annual Estate Planning, Guardianship and Elder Law Conference (August, 2015).

Myers and Dillon, “Who’s in Charge? Understanding and Using Directed Trusts,” 40<sup>th</sup> Annual Advanced Estate Planning & Probate Course, State Bar of Texas (June, 2016).

### VIII. Texas Directed Trustee Statute, Section 114.0031

Sec. 114.0031. DIRECTED TRUSTS; ADVISORS. (a) In this section:

(1) "Advisor" includes protector.

(2) "Investment decision" means, with respect to any investment, the retention, purchase, sale, exchange, tender, or other transaction affecting the ownership of the investment or rights in the investment and, with respect to a nonpublicly traded investment, the valuation of the investment.

(b) This section does not apply to a charitable trust as defined by Section [123.001](#).

(c) For purposes of this section, an advisor with authority with respect to investment decisions is an investment advisor.

(d) A protector has all the power and authority granted to the protector by the trust terms, which may include:

(1) the power to remove and appoint trustees, advisors, trust committee members, and other protectors;

(2) the power to modify or amend the trust terms to achieve favorable tax status or to facilitate the efficient administration of the trust; and

(3) the power to modify, expand, or restrict the terms of a power of appointment granted to a beneficiary by the trust terms.

(e) If the terms of a trust give a person the authority to direct, consent to, or disapprove a trustee's actual or proposed investment decisions, distribution decisions, or other decisions, the person is considered to be an advisor and a fiduciary when exercising that authority except that the trust terms may provide that an advisor acts in a nonfiduciary capacity.

(f) A trustee who acts in accordance with the direction of an advisor, as prescribed by the trust terms, is not liable, except in cases of wilful misconduct on the part of the trustee so directed, for any loss resulting directly or indirectly from that act.

(g) If the trust terms provide that a trustee must make decisions with the consent of an advisor, the trustee is not liable, except in cases of wilful misconduct or gross negligence on the part of the trustee, for any loss resulting directly or indirectly from any act taken or not taken as a result of the advisor's failure to provide the required consent after having been requested to do so by the trustee.

(h) If the trust terms provide that a trustee must act in accordance with the direction of an advisor with respect to investment decisions, distribution decisions, or other decisions of the trustee, the trustee does not, except to the extent the trust terms provide otherwise, have the duty to:

(1) monitor the conduct of the advisor;

(2) provide advice to the advisor or consult with the advisor; or

(3) communicate with or warn or apprise any beneficiary or third party concerning instances in which the trustee would or might have exercised the trustee's own discretion in a manner different from the manner directed by the advisor.

(i) Absent clear and convincing evidence to the contrary, the actions of a trustee pertaining to matters within the scope of the advisor's authority, such as confirming that the advisor's directions have been carried out and recording and reporting actions taken at the advisor's direction, are presumed to be administrative actions taken by the trustee solely to allow the trustee to perform those duties assigned to the trustee under the trust terms, and such administrative actions are not considered to constitute an undertaking by the trustee to monitor the advisor or otherwise participate in actions within the scope of the advisor's authority.

Added by Acts 2015, 84th Leg., R.S., Ch. 1108 (H.B. [3190](#)), Sec. 2, eff. June 19, 2015.

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University of Dayton – B.A.
- Experience:** 40+ years, specializing in wealth management and trust
- Trust Counselor LLC, Consultant to families and their trusts
- Texas Capital Bank - Executive Vice President, Chief Fiduciary Officer,  
Wealth Management and Trust Services (de novo start up), 1999 – 2014
- Comerica Bank-Texas – Manager, Trust Services in Texas, 1993 – 1999,  
acquired NorthPark National Bank (de novo start up, 1987-1993)
- Interfirst Bank Dallas – Manager, Personal Financial Consulting Services  
Department, 1980-1987
- Continental Illinois National Bank, 2<sup>nd</sup> Vice President, Trust, 1973-1980
- Articles:** TRUSTS AND ESTATES – Jan-Feb, 1986 “IRA Rollovers”  
ALI-ABA, 1986 Cassette tape on “IRA Rollovers”  
TEXAS LAWYER – June 16, 2001 “Play the Investment Game to Win”  
Master’s Thesis for L.L.M. (Tax) “IRA ROLLOVERS”
- Books:** **ROLLOVER STRATEGIES: TAX AND FINANCIAL PLANNING  
FOR LUMP SUM DISTRIBUTIONS FROM QUALIFIED PLANS,**  
1986, AMERICAN INSTITUTE OF CPAs
- Media Resource:** Quoted and resource, Dallas Morning News(Scott Burns and Pamela  
Yip), San Antonio Express, Fort Worth Business Press, American Banker,  
KVUE Austin (TV), The Future of the Financial Advisory Business (Mark  
Hurley, author)
- Professional Presentations:**
- Dallas, North Texas, Fort Bend (Texas), St. Louis, Hill Country (Texas),  
South Plains (Texas) and Waco Estate Planning Councils; Dallas Bar

Association, (Employee Benefits and Trust Estate and Probate Committees); Collin County Bar Association; Ft. Worth Pension Group; TBA Advanced Trust Forum; Office of the Comptroller of the Currency; SunGard Users Annual Conference; Texas Capital Bank Seminar on Texas Uniform Prudent Investor Act for Professionals.

**Professional and Community:**

Dallas County Bar Association  
Illinois State Bar, retired  
Metropolitan YMCA of Dallas – Board, former Executive Committee  
Metropolitan YMCA of Dallas Foundation, Chairman  
Metropolitan YMCA of Dallas Theodore Beasley Award 2014  
Parkland Health and Hospital System, Investment Committee  
Preston Center Rotary, Secretary 2016-2017  
Theodore Roosevelt Association, Chairman, Investment Committee  
Dallas Estate Planning Council, Past President 2011-2012  
Texas Bankers Association, Trust and Financial Services, Governmental Relations Committee (2003-2016)

**Expert Testimony:**

Federal Bankruptcy Court (re: qualification of an IRA rollover, 1992).

**Legislative Testimony:**

For Texas Bankers Association Trust Financial Services Division:

Legislative Session 2015 –HB 3190 House Business and Industry Committee and Senate Business and Commerce, regarding directed trustee legislation

Legislative Session 2011 - HB 1813 House Business and Industry Committee, Regarding contingent beneficiary rights to accounting

Legislative Session 2007 – HB 336 House Judiciary Committee, Regarding common law reporting duties of trustees