

Trust Protectors and Trust Advisors

I. Introduction

- A. Trust protector office—development in American trust law during past decade
 - 1. First popular to protect assets from settlor’s creditors
 - a. Later: protect assets against the actions of trustee.
 - 2. Before U.S. popularity—used in offshore common law jurisdictions
 - a. Originally as a check on local trustees in offshore asset-protection trusts (APTs),
 - b. Morphed into ordinary trusts
- B. Response to settlor uncertainty about future.
- C. Device to add flexibility to long-term trusts
- D. Increases settlor’s ability to control—even after death
- E. Primary uses
 - 1. Approve modifications to trust terms for
 - a. developments in the tax law
 - b. changes in beneficiary’s welfare
 - c. decisions regarding management changes

II. Definition—Trust Protector

- A. Someone appointed by settlor to act as an advisor to trustee and to ensure that trustee carries out settlor’s wishes
- B. Someone (other than trustee) authorized or required to play a part in trust administration
- C. Trust law of Nevis: person who is the holder of a power which when invoked is able to direct a trustee in matters relating to the trust and in respect of which matters the trustee has a discretion.
 - 1. Includes a person holding a power of appointment or powers to dismiss trustees.
 - 2. Similar definitions—laws of numerous other jurisdictions
- D. Other references: “Advisor”, “Appointor”, “Beneficiary Representative”, or even “Management Committee”

End result: a trust protector = a powerholder

III. What a Trust Protector is NOT

- A. Visitor
- B. Co-trustee
 - 1. Courts still likely to draw analogies to co-trustees
- C. Trust Advisor
 - 1. Position used often in the U.S.—may not be thought of as a “protector” even though that is what an advisor is.
 - 2. Some state domestic asset protection trust statutes, specifically mention term trust “advisor” includes a protector

- a. Delaware
 - b. New Hampshire
 - c. Rhode Island
 - d. Tennessee
 - e. Utah
 - f. Alaska: refers to terms protector and advisor separately
 - i. Requires protector be disinterested third party...seems to rule out beneficiary protectors
- D. Virtual trustee
- E. Directed trustee
- 1. Comes from directed or direction trusts— and was an exception to general common law prudent-man rule wherein a trustee had to personally make all discretionary decisions related to the trust
 - 2. Generally—banks and trust companies like directed trusts because they don't have to worry about managing assets in which they have no expertise
 - a. Setting up a directed trust: settlor needs to be careful when choosing the outside manager, (called a co-trustee, protector or advisor,
 - i. Someone good/trustworthy who can be held accountable
 - ii. Banks may still get fee on special asset it doesn't manage due to performance of basic administrative work re: asset
 - b. S. Dakota—first state to expressly enact a directed trustee statute
 - c. Florida recognized general power of direction without expressly referring to it as directed trust arrangement
- F. Corporate directed trustee
- 1. Corporate direct trustee delegates investment responsibility to another firm even though delegating firm has ability under trust terms to manage investments
 - a. Benefit of corporate directed trust: allows a financial institution with state or federal trustee powers to serve as trustee while allowing settlor to choose his trusted investment advisor to manage his trust along with the grantor's other assets.
 - b. Allows settlor to consolidate assets with one investment advisor who has long understood the grantor's financial status/objectives
- G. Certified trust advisor
- 1. Con artists mass marketing living trusts to unwary Hawk living trust scams

IV. Background

- A. "Protector" = relatively new term but concept of non-trustees having powers over trust property is old/not indigenous to American trust law
- B. England's courts and other major trust jurisdictions have had non-trustee concept for centuries
 - 1. Even before last two decades: some English trusts used protectors to reassure settlors uneasy about powers conferred on trustee. The implied contract that represents a mutual agreement for the advisor and prospect to

continue to work together following the initial fact-finding interview is the discovery agreement. This agreement summarizes the prospect's retirement planning goals and concerns, and it confirms his or her willingness to seek solutions that meet those goals and concerns within the prospect's budget and time horizon. Although the discovery agreement can be verbal, it is usually written and provides a blueprint for the next steps in the selling/planning process.

V. Statutory Recognition

A. Until 1980s—offshore trust industry mostly English-via English colonies

1. Attractive as tax havens
2. Most tax advantages disappeared for when Tax Reform Act of 1976 enacted
 - a. IRS would treat assets of most foreign trusts settled by Americans as the settlor's assets for income tax purposes
 - b. Remain popular with some American settlors because financial institutions in some former British colonies retain the English tradition of bank secrecy
 - c. Today often used to avoid creditors, not taxing authorities

B. Cook Islands' International Trusts Act of 1984.M

1. Self-settled spendthrift trusts fully enforceable
2. Creditors can't reach settlor's interest even if settlor retains the right to revoke trust
3. Can't attack transfers as fraudulent conveyance
4. No enforcement of foreign judgments
5. Many offshore jurisdictions embrace some features
6. First offshore statutory definition of "protector"—Cook Islands 1989

C. U.S.

1. South Dakota—1st statute explicitly recognizing trust protectors 1997
2. Idaho 1999
3. Alaska and Wyoming 2003
 - a. Alaska and Delaware competed for asset protection trusts
 - b. Not Cook Island type protection but do offer:
 - i. ease of access to trust assets,
 - ii. lower costs,
 - iii. greater political stability
4. Tennessee 2004.
5. Above 4 states (not Alaska) insulate trustees from liability for following TP directions
 - a. Called "excluded fiduciaries"
 - b. Alaska is silent on this issue
 - c. Alaska is also different from the other 4 with respect to fiduciary standing
 - i. TP not liable/accountable as a trustee or fiduciary unless terms provides otherwise
 - ii. Opposite with other 4 states—TP held to fiduciary standards unless the trust terms say differently.

- iii. Idaho and Wyoming—TP = fiduciary
 - 6. Most states—
 - a. No statutory provision for protectors
 - b. No developed case law defining relationships among protectors, trustees, settlors, and beneficiaries.
- D. Uniform Trust Code (UTC) (revised/amended 2005)
- E. Promulgated in 2000 (amended 2001, 2003, 2004 and 2005—first comprehensive national codification of the law of trusts—provides the opportunity to examine modern approach regarding the balance between the property rights of settlors wishing to control the future enjoyment of their property and the interests of beneficiaries when those interests conflict/seen to conflict with settlor’s limitations
- F. § 808 Powers to Direct
 - 1. § 808(c) Trust terms may confer upon a trustee or other person a power to direct the modification or termination of the trust.
 - 2. Adopted in some form in 18 states plus D.C. (as of 2007).
 - 3. UTC standard requires trustee exercise “minimal oversight responsibility” before following protector’s directions
 - 4. UTC does not provide trustees with absolute immunity from liability for following protector’s directions
 - 5. UTC creates a presumption that holder of “power to direct” = fiduciary.
 - a. §808(d): A person, other than a beneficiary, who holds a power to direct is presumptively a fiduciary who, as such, is required to act in good faith with regard to the purposes of the trust and the interests of the beneficiaries. The holder of a power to direct is liable for any loss that results from breach of a fiduciary duty.
 - b. Comments to § 808: provisions can be altered in the terms of the trust
 - i. states that a settlor could provide that protector is not held to standards of a fiduciary
 - 6. Approved by
 - a. American Bar Association
 - b. ABA Real Property, Probate and Trust Law Section
 - c. AARP
 - 7. State adoptions
 - a. Alabama
 - b. Arizona
 - c. Arkansas
 - d. District of Columbia
 - e. Florida
 - f. Kansas
 - g. Maine
 - h. Missouri
 - i. Michigan
 - j. Nebraska
 - k. New Hampshire
 - l. New Mexico

- m. North Carolina
 - n. North Dakota
 - o. Ohio
 - p. Oregon
 - q. Pennsylvania
 - r. South Carolina
 - s. Tennessee
 - t. Utah
 - u. Vermont
 - v. Virginia
 - w. Wyoming
8. 2009 Introductions
 - a. New Jersey
- E. Uniform Prudent Investor Act (Sec. 9) of 1994 (UPIA) adopted by majority of states.
1. Prudent man rule evolved into the prudent investor standard
 2. UPIA followed the modern portfolio theory which emphasized market risks are necessary to yield higher returns
 3. It's the trustee's duty to:
 - a. find the appropriate balance of risk and return;
 - b. establish diversification
 4. Allows trustees to delegate discretionary functions to third parties...
 - a. failure to delegate could be deemed imprudent—some situations
 5. Explicitly allowed trustees to delegate investment functions (currently there's little case law)
 6. UPIA explicitly states an agent solely liable for actions within scope of duties.
- F. Other uniform fiduciary laws allowing delegation:
1. Uniform Management of Institutional Funds Act (1972)
 2. Uniform Trustee Powers Act (1964)
 3. Employee Retirement Income Security Act (1974)
 4. Restatement (Third) of Trusts (1992)
- VI. What's the attraction?...reasons for having a protector
- A. Rule Against Perpetuities (RAP)
1. Increasing number of states have:
 - a. Adopted an unlimited RAP
 - b. Greatly extended period in which trust for private beneficiaries may last or
 - c. Allowed opting out of RAP
 2. Seven states—repealed RAP outright
 - a. Alaska
 - b. Idaho
 - c. New Jersey
 - d. Pennsylvania
 - e. Rhode Island
 - f. South Dakota

- g. Washington
- h. Delaware—repealed RAP for interests in personal property but has 110 year rule for trust property held
- 3. Numerous states—extended the period—
 - a. Ex. Florida 360 years
 - b. Utah 1,000 years
- 4. Other states—effectively abolished RAP by giving settlors ability to opt out of RAP’s application to trusts.
- 5. Protector—to provide flexibility to meet changes during continuance of trust
- B. Increasing use of domestic asset protection trusts (DAPTs)
 - 1. Numerous (at least 9) states permit irrevocable trust form in which settlors can obtain spendthrift protection
 - 2. Domestic and offshore asset protection trusts settlors want mechanisms for changing trust terms for unforeseen/foreseen circumstances
- C. Super flexibility
 - 1. One main thrust behind trust protectors reverses previous limited flexibility
 - a. For generations attorneys required to draft trusts with standard, long-accepted forms of flexibility
 - i. Especially trustee removal and powers of appointment
 - 2. Protectors intended to offer super flexibility that at first blush allows settlor to consider every conceivable future circumstance
 - a. Can rush for flexibility/attempts to crystal ball future circumstances end up including powers that do more harm than good?
 - i. Spark trustee-protector conflicts—backdrop for expensive litigation and court involvement?
- D. Relieve beneficiaries of primary responsibility for monitoring trustee
 - 1. How does settlor ensure trustee acts in accordance with settlor’s expectations?
 - 2. Trust law’s traditional response is to enlist beneficiaries as monitors thru action for breach of fiduciary duty mechanism
 - 3. But...monitoring by beneficiaries costly/imperfect,
 - a. Beneficiaries often lack expertise to detect breach
 - b. Beneficiaries may be dependent on trustee—reluctant to rock boat
 - c. Factors suggest potential underdeterrence of trustee misbehavior
- E. Precaution against trustee becoming unsatisfactory
 - 1. Settlor concerned court won’t replace trustee unless situation is substantial—plus the costs involved
- F. Reassurance discretionary trustee will observe settlor’s non-binding distributions wishes
 - 1. Veto power over distribution decisions may be appropriate
- G. Involve someone having knowledge about settlor’s family
- H. Keep tax planning of trust current
 - 1. Protector may be tax expert but more commonly is someone who obtains tax advice to guide trustee

- 2. Many trustees happy to have tax matters reduced to practical guidelines
 - I. Provide trustee/beneficiary liaison to keep both informed
 - 1. Hopefully reduce beneficiary-trustee conflicts
 - J. Enable beneficiary participation at some level in trust administration
 - 1. Usually re: investments—beneficiaries having consent and/or consultation powers
 - K. Portray appearance of offshore trust with an offshore trustee while real trust administration conducted onshore by protector
 - 1. Dangerous practice—much rests on concealment of facts
 - L. Summary of general reasons for using trust protectors:
 - 1. Guard trust from hazards threatening achievement of its objectives
 - 2. Improve performance of trust functions
 - 3. Participation of beneficiaries in trust administration
 - 4. Permit trust to go where trustees dare not go???
- VII. Negative side of using Trust Protectors
- A. Legal position uncertain
 - 1. Not usual practice for trust to lay down comprehensive rules
 - a. Numerous reported cases about dispositive powers held by non-trustees—fewer regarding administrative powers
 - 2. Where trust is silent, court forced to discover settlor’s intentions from any available clues
 - B. Protector device can sometimes backfire by enabling courts to impute control over trust to settlor when settlor/family member named trust protector
 - 1. *Anderson case (Federal Trade Commission v. Affordable Media, LLC)*, the courts concluded that settlors retained control of their offshore (Cook Islands) trust because they made themselves trust protectors. (Case also involved an anti-duress clause; plus the Andersons were trustees along with a company licensed to provide trust services in the Cook Islands.) As trust protectors, Andersons had the power to appoint new trustees and other powers.
 - 2. If a settlor is also the trust protector, an American court can order him to direct the foreign trustee to repatriate the trust’s assets.
 - a. Subjection to court’s jurisdiction could also occur if protector is settlor’s friend or relative
 - 3. To protect against these kinds of actions by American courts, protector’s powers should be formulated as negative powers:
 - a. Ex. power to veto acts or decisions of foreign trustee
 - b. Not affirmative powers—like the right to appoint new trustees or transfer trust assets
 - C. Why not use durable power of attorney (DPOA) instead?
 - 1. Only some states allow attorney-in-fact under DPOA authority to amend an estate plan
 - a. Ability to amend estate plans varies state to state
 - b. Not so with a protector
 - D. Additional tax exposure potential

1. To avoid adverse tax consequences, protector should be independent Party
- E. Disrupts smooth trust business process
1. Delay—trustees may have to wait on protector consent before exercising powers/discretions
 - a. Solution: well-thoughtout, carefully drafted trust provisions delineating protector rights/responsibilities re: trustees/beneficiaries
- VIII. Duties—General
- A. Trustee (how issues and increased use of trust protectors are handled under Texas (and other states) modernized Property Code)
1. Normally, the trustee must follow instructions of protector
 - a. Except when:
 - i. Protector’s instruction manifestly contrary to trust terms of the trust
 - ii. Trustee knows instruction constitutes breach of protector’s fiduciary duty
- B. Protector
1. Presumed to be fiduciary
 - a. Required to act in good faith
 - i. Trust purposes
 - ii. Beneficiaries’ interests
 - Beneficiary-protector excluded from presumption
- IX. Selecting a Trust Protector (Who may serve)
- A. General—someone familiar with: settlor’s intentions/beneficiaries
- B. Settlor
1. Could be—but not with reserved powers to self as settlor
 2. Bad idea generally
 - a. Same reason grantor generally shouldn’t be trustee—possibly viewed as retained §§2036/2038 powers
- C. Relative/close friend/subordinate party
1. Possible—caution required in appropriate circumstances.
 2. Old family or business friend
 - a. Motives
 - i. Respect for judgment
 - ii. Wish to give tangible recognition of settlor’s esteem
 - iii. Desire to employ someone closer to family than trust officer of local trust company or bank
 3. Possible risk IRS could argue facts/circumstances show protector under settlor’s control or “pre-understanding” exists
 - a. Usually only when facts egregious
 - b. If dollar amounts great—wise to use independent protector
- D. Professional advisor of settlor (lawyer, CPA, etc.)
- E. Professional protector
1. Individual

- 2. Corporate
 - a. Ex.: some law firms have protector companies to look after clients' trusts
 - F. Combination of above—would act as committee
 - G. Settlor can't make a selection
 - 1. No one in whom settlor has sufficient confidence
 - a. Perhaps beneficiaries/others permitted to name protector if/when warranted
 - b. Successor protectors—same approach
- X. Trust Protector Powers
- A. Authorized to perform a function—generally = a *power*
 - 1. Permissive
 - B. Required to perform a function—a *duty*
 - 1. Mandatory
 - C. Neat and clear?
 - 1. Not when duties accompanied by discretion
 - 2. Not when protector has choices in deciding how to perform duties
 - 3. “Hazyville” prevails—no clear dividing line
 - D. No clear distinction between “dispositive powers” and “administrative powers”
 - 1. Can overlap/intrude upon one another
 - 2. Dispositive powers typically pertain to beneficial arrangements
 - a. Who beneficiaries are
 - b. What/when beneficiaries should receive
 - 3. Administrative powers pertain (again broadly) to investment/management matters
 - E. Middle of the road powers
 - 1. Power to direct making loans to beneficiaries = both investment of trust fund and benefit to borrowing beneficiary
 - 2. Consent required for acquisition of new investments = administrative but acquisition can benefit beneficiaries
 - a. Income beneficiaries—higher income, or
 - b. Remaindermen—capital appreciation
 - c. Note: As general rule, may be better to use power of consent rather than power of direction when it comes to new investments
 - i. Wording might include: “The trustee may not sell my shares of “How To” without the written consent of my trusted advisor, Jane Doe.”
 - ii. With consent—initiation of changes is left in hands of trustee.
 - iii. Terms should provide: consent not unreasonably withheld
 - d. If directional power:—advisable to surround power with safeguards
 - i. Amplify exculpatory clause with explicit detail
 - ii. Ex.: “Trustee has no duty to inquire since the ‘settlor’ has implicit confidence in the judgment of ‘protector’.”

- iii. “The trustee shall invest trust funds in such securities as ‘trust protector’ (investment committee, for example) may direct; no security shall be sold or purchased without the written directions of the ‘trust protector’ (investment committee).”
 - F. Type/range of powers may vary widely
 - G. Temptation to grant protector as many powers as come to mind
 - 1. Attempt to grapple with potential future beneficiary, law, and societal (public policy) changes
 - 2. Settlor better advised to reign in “powers gone wild” temptations
 - 3. Over use of powers could lend itself to:
 - a. Trustee-protector conflicts
 - b. Costly courtroom confrontations
 - H. Best recipe
 - 1. Settlor and attorney make utmost effort to reasonably anticipate powers most likely to carry out trust purposes
 - 2. Thorough consideration/understanding of consequences of each/every power granted
 - 3. Avoid powers for sake of powers
- XI. Common powers and uses
- A. No established “standard” powers given to those holding protector position
 - B. Power of amendment
 - 1. Usually within three categories
 - a. Address changes in tax laws/other legal or factual changes impacting trust
 - i. Ex.: If the rules governing when annual exclusion gifts to Crummey power trusts changed and new rules became applicable to future gifts to trusts including pre-existing irrevocable insurance and gift trusts, protector could modify trust terms to qualify under new rules, or have insurance distributed if rules destroy viability of trust
 - b. Amend administrative provisions
 - i. Ex.: Trustee removal
 - ii. Appointment powers
 - iii. Trustee investment powers
 - Ex.: A power to amend administrative terms could allow a protector to add investment powers if certain investments not clearly permitted under the terms of the trust become widely desirable in the future.
 - c. Alter beneficiaries’ trust interests
 - i. Note: Has potential for misuse in wrong hands
 - C. Add and/or delete beneficiaries
 - D. Add/replace/remove trustees
 - 1. If unqualified—protector can act with or without cause
 - 2. If qualified—power more circumscribed
 - a. Ex: “only if requested by majority of adult beneficiaries”

- b. See: *Von Knieriem v. Bermuda Trust Co. Ltd, 1 BOCM 116 (Bermuda High Ct., 1994)* where the trustee who was removed (and replaced) by a protector refused to turn over the assets until a court ruled on the propriety of the protector's actions. The court placed emphasis on whether or not the protector acted in a fiduciary capacity. (Meanwhile, back at the trust ranch, this increased agency costs for the trust)
- 3. Scenario:
 - What if protector doesn't like way trustee is exercising his discretion to make beneficiary distributions but yet trustee hasn't committed any breach of trust or duty. Is it legitimate for protector to replace the trustee in these circumstances? This is where a settlor's "*letter of wishes*" would be helpful in indicating whether or not trustee was acting consistently with settlor's goals.
- E. Change trust situs (change governing law of trust)
- F. Affect trust distributions
 - 1. Through veto or directive powers
 - 2. Distribute property to another trust created by settlor
 - a. Note: no distributions should be made to another trust in which settlor has §2036/§2038 powers or beneficial interest
- G. Approve self-dealing by trustee(s)
- H. Veto beneficiary rights
 - 1. Ex.: right to trust accounts or information
- I. Consent to the exercise of powers of appointment
- J. Dispositive powers
 - 1. Examples of why a protector may be given dispositive powers:
 - a. When settlor has no particular views on who within family should take on trust termination—wants to leave decision to responsible person knowledgeable about family circumstances
 - b. Settlor wants fine tuning of dispositive arrangements according to changing circumstances
- K. Affect investment decisions through vetoes or directives
- L. Approve trustee accounts
- M. Approve the trustee's remuneration
- N. Nominate auditors
- O. Release trustees from liability for breach of trust
- P. Terminate the trust by commencing a final vesting provision
- Q. Enforce the trust by legal proceedings
- R. Enforce trusts for care of pets
 - 1. Historically, common law of many states recognized settlors' ability to create "honorary trusts" through which they could leave care of their pets after settlor's death
 - a. Problem: Not enforceable—trustees acted more out of moral duty
 - 2. UTC and numerous state statutes allow enforcement of trusts for pets
- S. Request/receive information in lieu of beneficiaries

1. A few UTC jurisdictions allow settlor to substitute a “party” for beneficiaries
Re: duty to inform
 2. Critics of this power: granting this power to surrogate generally unsupportable/not understandable
 - a. Some rights to information should remain in beneficiaries
- T. Unusual for protector to have all/even majority of above powers/functions

Note: the more power given to the protector over the trustee, the more risk there is of making the trustee look like a mere agent.....probably not what settlor contemplated/ would have wanted

XII. Disallowed powers

- A. No furtherance of any illegal purpose
- B. Nothing against public policy
 1. May be a moving target
 2. May change state to state
 - a. Beware if power to change trust situs
- C. Possible public policy no-no’s that go against the very grain of trust premises
 1. Disallow beneficiary from seeing trust terms
 2. Exculpate trustee for failing to make accounting
 3. Prevent beneficiary from having an accounting

XIII. Fiduciary or not?

- A. Determination of relationship/roles between protector and trustee dependent on this underlying issue
 1. Is protector deemed a fiduciary or nonfiduciary merely having personal powers?
 - a. Roles of two functions different depending on answer
- B. If not a fiduciary
 1. Protector holds purely personal powers—cannot be forced to exercise powers
 - a. Potential: capricious exercise of powers
 - i. Possible to act out of spite/even maliciously (as long as no fraud)
 2. Trustee’s response to protector’s personal, nonfiduciary powers
 - a. No duty to question reasonableness of protector’s actions
 - i. unless outrageous/out of line
- C. If fiduciary
 1. More likely a protector hold powers in fiduciary capacity than as personal powers
 2. Trustee in more sensitive position
 - a. Even with trust provision exculpating trustee from liability for acting/not acting by protector’s decisions
 3. Subject to court supervision
 - a. In *Steele v. Paz Ltd.*, 1995 Isle of Man case, trust terms provided for protector to consent to selection of beneficiaries and to all distributions

to them but trust neglected to name a protector. Court appointed a protector rather than have the trust fail based on premise that powers were fiduciary in nature.

4. Compensation—characteristic separating fiduciary and personal powers
 - a. Fiduciaries—right to reasonable fees for efforts/reimbursement for expenses
 - b. If protector a fiduciary—entitled to compensation
 - c. Noncompensated trustees—held to same fiduciary standards as other trustees
 - i. Follows—protectors cannot escape liability because no compensation
5. Protectors with directional powers -typically deemed fiduciaries
6. Protectors with consent/veto powers – more likely brings up fiduciary or non fiduciary issues

Note: Decades ago trust advisors, while recognized by courts as not being co-trustees, were recognized as being fiduciary in nature by comparing them to co-trustees but with limited authority (*Gathright's Trustee v. Gaut* and *Lewis v. Hanson*)

7. Fiduciary issue from protector's side
 - a. If fiduciary, same rights as a fiduciary?
 - b. If not fiduciary, without any rights?
 - c. Few cases addressing protector rights—no clear direction on subject
 - d. Two cases addressing protector rights -found implied powers
 - i. 1982 U.S. case, *Sheldon, et al. v. The Trust Co. of The Virgin Islands*—court permitted protector to be a plaintiff in action against trustee for breach of trust
 - ii. *Von Knieriem v. Bermuda Trust Co. Ltd, 1 BOCM 11 (Bermuda High Ct., 1994)* court recognized protector's right to bring action against removed trustee who wouldn't transfer assets to new, protector-appointed trustee
 - iii. In neither case did courts find protector lacking fiduciary right to prosecute
8. Protector/settlor relationship—may answer fiduciary determination
 - a. Close family member/object of settlor's bounty—logical conclusion: personal powers/nonfiduciary role
 - b. Advisory capacity relationship—expectation: fiduciary role
9. Whether position constitutes an “office” as opposed to mere naming individual
 - a. Trustee positions held as an “office”
 - b. Generally—there's a protector “office” based on types of powers granted
 - i. Provisions for appointment/removal/resignation of protectors
 - ii. Provisions for successor protectors/compensation
10. Degree of empowerment

- a. Ex.: Extensive directive powers over trust investments v. main task to soothe beneficiaries' ruffled feathers
- 11. One size fiduciary standards, if any, does not fit all
- 12. Why difficult for courts to determine fiduciary rules for protectors
- 13. Ideal: settlor specifies standards governing protector's conduct

XIV. Liabilities and Remedies

- A. Protector's liabilities can be summarized as a matter of contract
 - 1. Articulated in trust instrument
 - 2. If instrument silent/incomplete re: liabilities—left to courts to eventually develop default rules
- B. Liabilities not limited to damage actions against protector
 - 1. Ex.: Trustee and protector at odds
 - a. Trustee should seek judicial directions
 - i. Not seeking to compel action by protector but rather obtain judicial approval for trustee's own actions
 - 2. Ex.: Trustee fears by following protector's direction trustee will breach fiduciary duty.
 - a. Trustee alternatives
 - i. Follow protector's direction
 - ii. Seek judicial approval to follow protector's directions
 - iii. Seek beneficiary approval
(Note: beneficiaries may be inadequate monitors of own interests)
 - 3. Beneficiaries and protector at odds.
 - a. Three alternatives are available to beneficiaries
 - i. Seek to compel protector to take specified action (uphill battle for beneficiaries)
 - ii. Seek to remove protector
 - iii. Seek damages for breach of fiduciary duty

XV. Issues:

- A. Is protector employed for benefit of beneficiaries or benefit of settlor's wishes/intentions?
 - 1. Ex.: (tracks along lines of Pulitzer case) Trust document expressly states trustee may not sell a particular inception asset which happens to constitute a major portion of trust portfolio. Value of asset tanks after settlor's death threatening ability of trust to provide for all beneficiaries. A protector employed to carry out settlor's wishes comes to different conclusion than protector employed to act in beneficiaries' best interests
 - 2. If employed for beneficiaries' benefit—assumption: in settlor's judgment beneficiaries better off because of protector
 - a. Protector's roles
 - i. Corporate board of directors type role: oversees performance of management on behalf of shareholders (ie., trust beneficiaries)

- ii. Judicial type role: hears/resolves disputes between beneficiaries and trustee
 - 3. Vast majority of trust issues: settlor's interest and those of beneficiaries closely aligned agency costs are minimized when the protector acts as the settlor would want it to.
- B. What guarantee is there that protector will do as settlor would want?
- 1. Personal loyalty to settlor may act to discipline protector
 - a. Especially when protector = close friend/confidant/ relative of settlor
 - 2. What if no strong bond to settlor (professional protectors/successor protectors)
 - a. Even with detailed settlor instructions—no real market mechanism to assure following instructions.
 - b. Protector compensation not easily tied to degree of fealty towards settlor's wishes
 - c. Protector's performance difficult to measure
- C. Is trustee completely absolved from following protector's direction within powers even if improper?
- 1. Some state statutes insulate trustee from liability for follow protector directions (Ex.: Tennessee)
 - 2. Other statutes denominate trustees who have received directions from protector
 - a. Trustee deemed "excluded fiduciary" (Ex.: South Dakota)
- D. Is the trustee in clear if trustee himself acts improperly although action required/received protector's consent?
- E. What happens when trustee may not act without protector's approval—trust administration can be paralyzed by protector's inaction
- 1. By contrast, when trust provisions give protector power to initiate actions, protector's failure to exercise power does not prevent trustee from administering trust because the trustee doesn't need the protector's approval
 - 2. Protector's failure to act may require some investigation
 - a. Ex.: Does inaction have root in beneficiaries' best interests
 - b. One acceptable standard—protector liable for breach by failing to act only if
 - i. Protector made no reasonable inquiry into trustee's behavior, or
 - ii. No reasonable person would fail to act on facts presented
- F. What happens if protector persistently refuses to consent to proposed action trustee considers necessary for protection/best interests of trust?
- 1. Trustee is under duty to continue to seek protector approval
 - 2. Court authorization to act may be necessary
 - 3. With directional powers of protector, trustee's duty reduced unless knowledge protector violating duty to beneficiaries/other great misstep
 - a. Failure to seek court instructions could result in trustee being surcharged
 - b. Resolution concerning investments through legislation—some states

- i. Trustee relieved of duty to check on advisor's discretionary act (Florida, Georgia)
 - 4 .Basic premise of trust arrangements demands trustees uphold their fiduciary responsibilities—including protector's actions/nonactions
 - a. Otherwise trustee is mere agent of protector
 - G. Will trustee expend energy/time persuading protector of trustee's decisions where protector has consent/veto powers over trustee's decisions?
 - 1. Divert energies from trustee's ultimate obligation to beneficiaries/trust purposes
 - H. Is the quality of the trustee's decisions threatened by protector's presence?
 - 1. If so, appointment of protector counterproductive
 - I. Will trustee expend less decision-making care since trustee knows protector will review its decisions?
 - J. Does protector's role concern management issues or distribution issues?
 - 1. If management issues: trustee = primary manager of trust assets/protector = mainly monitor
 - 2. If powers to alter distribution scheme (timing and method of distribution): Protector = primary decision-maker rather than trustee
 - K. Do protectors only serve to quell settlors' fears?
 - 1. If so, protectors may mainly serve as security blankets
 - L. If protector employed to serve settlor's intent: less effective after settlor's death?
 - K. What are social welfare costs/benefits of adding trust protectors to tool box available to settlors?

XVI. Exculpatory Provisions

- A. Not relieve fiduciary of liability if provision:
 - 1. Doesn't cover breach of duty involved
 - 2. Against public policy
 - 3. Inserted in document without settlor's knowledge/consent
- B. General Rule: Exculpatory provisions strictly construed against fiduciary
 - 1. Historically, courts unreceptive to attempts to relieve fiduciaries of liability for error more serious than ordinary negligence
 - 2. All jurisdictions: not relieved for gross negligence/willful misconduct
 - 3. *Tuttle v. Gilmore*, 36 N.J. Eq. 617 (Ct. Err. & App. 1883): trust instrument provided trustee was liable only for willful and intentional breaches of trust. Trustee surcharged for investing in second mortgages which became worthless because court said investing in hazardous securities constituted a willful and intentional breach of trust even though the trustee's actions were for the benefit of the trust fund and not for personal advantage.

XVII. Tax consequences/considerations

- A. Protector with personal powers exercisable for own benefit—general power of appointment potential
 - 1. Owner of assets—income/estate tax

- B. Protector cannot benefit self—special power
 - 1. Avoids tax ramifications generally
 - a. If protector = trust beneficiary may be different result
 - b. If protector exercise power in favor of someone protector owes legal obligation of support—adverse tax consequences for income so used plus full estate inclusion possible
 - i. unless ascertainable standard
 - c. See: Alexander A. Bove, Jr. “Powers of Appointment: More (taxwise) Than Meets the Eye,” Estate Planning. New York: Oct. 2001. Vol. 28, Iss. 10.
- C. Protector who is a fiduciary should not be deemed to hold general power

XVIII. Enforcement

- A. Main issues
 - 1. What if protector doesn't do what he's supposed to do?
 - 2. Who has right of enforcement?
 - 3. Who watches protector?
 - 4. How does court enforce constraints/obligations imposed on protectors?
- B. Issue: whether protector validly exercised power affecting trust
 - a. Trustee/beneficiary/even protector may apply for court decision
 - b. Court decides power invalidly exercised (ex.: protector acted for improper purpose): protector action = nullity
 - i. But: suppose trustee relied on protector's now invalid direction/consent/etc.
 - Ex.: trustee makes improper distribution to beneficiary
 - c. Who pays?
 - i. Beneficiary is made to return distribution (what if he no longer can?)
 - ii. Trustee acted without due authority because protector's act invalid—court may excuse trustee if determined trustee acted honestly/reasonably...trustee excused if grounds for suspicion
 - iii. Protector breached trust/held accountable
- C. Court' testing propriety of protector conduct apart from express terms of powers:
 - a. Determine whether protector acted for proper purpose, and
 - b. Whether protector obligated to serve—if so, whether protector did his best
- D. Settlor gave protector discretion, not court
 - a. Presumption: settlor doesn't want court interference
- E. Courts have mechanisms for enforcing trustee duties
 - 1. Same for protectors (probably)—some differences because protector not = trustee
 - 2. Not clear court has jurisdiction to remove/appoint protectors
 - 3. Court can: direct trustees to disregard protector directions
- F. Alternative of court involvement: settlor/trustee/beneficiaries given right to replace protector under delineated circumstances

1. Ex.: protector persistently fails to discharge obligations

XIX. Agency costs

- A. Definition: sum of the principal's monitoring expenditures, the principal's bonding (of the agent) expenditures, and the principal's residual loss as a result of the divergence of principal's and agent's interests
- B. Protector criticism: creation of greater administrative burden for trustees— increase trust expenses
- C. Opposite claim: when settlor appoints trusted friend/confidant to monitor trustee's management overall net agency expenses reduced
- D. Will protector position reduce agency costs often identified in trust relationships or will protector office create own agency costs offsetting cost reductions associated with trustee's position?
- E. If purpose of protector to protect beneficiaries' interests: protector available to resolve potential lawsuits at low cost
 1. Saves beneficiaries: having to raise money/underwrite lawsuit/publicity of court case
 2. Substitution of protector for court: reduces load on publicly supported Tribunals
 3. Argument: Internalization of dispute resolution costs good for beneficiaries/public
- F. One set of circumstances should, perhaps, always prevail: when all beneficiaries agree protector not serving their interests, beneficiaries allowed to eliminate protector's compensation (if compensated)/less drain on trust assets
- G. Argument: In ordinary case—protector merely one more agent and therefore not solution to agency costs

XX. Sample Trust Provisions concerning trust protectors

A.

A. I appoint _____ as Trust Protector hereunder. If _____ fails or ceases to act as Trust Protector, he may (but is not required to) appoint any one or more successor Trust Protectors as provided in the following paragraph. No trust created under this instrument is required to have a Trust Protector acting with respect to that trust.

B. The Trust Protector acting from time to time, if any, may appoint any one or more individuals (other than me, my spouse, or a descendant of mine) as successor Trust Protector. Any appointment of a successor Trust Protector hereunder shall be in writing, may be made to become effective at any time or upon any event, and may be single or successive, all as specified in the instrument of appointment. The Trust Protector may revoke any such appointment before it is accepted by the appointee, and may specify in the instrument of appointment whether it may be revoked by a subsequent Trust Protector. In the event that two or more instruments of appointment or revocation by the same Trust Protector exist and are inconsistent, the latest by date shall control.

C. Any Trust Protector may resign by giving prior written notice to the trustee. All trusts created under this instrument need not have or continue to have the same Trust Protector. The provisions of this instrument that relate to the Trust Protector shall be separately applicable to each trust held hereunder.

D. The Trust Protector may, with respect to any trust as to which the Trust Protector is acting, modify or amend:

1. The trust administrative provisions relating to the identity, qualifications, succession, removal and appointment of the trustee;

2. The financial powers of the trustee enumerated in [identify financial powers Article];

3. The provisions of Article relating to the identity of the contingent beneficiary of trust property;

4. The withdrawal rights granted under [identify paragraph and Article giving the beneficiary withdrawal rights] (except a withdrawal right already in existence at the time the Trust Protector seeks to exercise the power conferred under this subparagraph); and

5. The terms of any trust with respect to (i) the purposes for which the trustee may distribute trust income and principal, and the circumstances and factors the trustee may take into account in making such distributions, (ii) the termination date of the trust, either by extending or shortening the termination date, and (iii) the identity of the permissible appointees under the testamentary power of appointment granted to the beneficiary for whom the trust is named.

E. Notwithstanding any other provision of this instrument, the Trust Protector shall not participate in the exercise of a power or discretion conferred under this instrument that would cause the Trust Protector to possess a general power of appointment within the meaning of Sections 2041 and 2514 of the Code.

*F. The Trust Protector acting from time to time, if any, on his or her own behalf and on behalf of all successor Trust Protectors, may at any time irrevocably release, renounce, suspend, cut down or modify to a lesser extent any or all powers and discretions conferred under this instrument by a written instrument delivered to the trustee. **

B.:

The Trustee Appointer acting from time to time, may appoint any one or more individuals who would qualify as independent trustees as Trust Protector. Any appointment of a Trust Protector hereunder shall be in writing, may be made to become effective at any time or upon any event, and may be single, joint or successive, all as specified in the instrument of appointment. The Trustee Appointer may revoke any such appointment before it is accepted by the appointee. An appointment that has not been accepted by the appointee may be revoked by a subsequent Trustee Appointer unless the instrument of appointment specifies otherwise. In the event that two or more instruments of appointment or revocation exist and are inconsistent, the latest by date shall control.

*One other issue which should be addressed when the trust is created is providing for successor trust protectors. **

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XXI. Cases—miscellaneous concerning trust “advisors”

Federal Trade Commission v. Affordable Media, (Anderson case) 179 F. 3d 1228, C.A. 9 (Nev.) 1999 (see Cornell Law Review – “Asset Protection Trusts: Trust Law’s Race to the Bottom?” fn. 38)—protector can be compelled to repatriate assets unless protector powers are drafted solely as negative veto type powers over trustee decisions and when protector’s powers are subject to the anti-duress provisions of the trust. In *Anderson*, the protector had affirmative powers.

McLean v. Davis, 283 S.W.3d 786 (Mo.App. S.D., January 2009) (No. SD28613) [only state case using term “trust protector” a special needs trust.] Suit (appellate court) by trustee, who is also the beneficiary’s mother, against predecessor trustees and protector (attorney) alleging they had improperly administered the trust and depleted its assets. Function of “Protector” is a question of first impression.. Trust protector has fiduciary capacity under trust provisions but is not, under trust terms, liable for any action taken in good faith (qualified immunity for good faith efforts). Protector can remove trustee and appoint successor trustee and can appoint successor protector. Protector did resign but did name a successor. Claim was that protector failed to monitor and report expenditures; failed to stop trustee when trustees were acting against interests of beneficiary; and placed loyalty to trustees and their interest above those of beneficiary to whom fiduciary obligation was owed. Protector claimed document did not impose any legal duty to supervise the trustees. Trust does not provide specific fiduciary duties owed by protector...that trust was just created for purpose of investing beneficiary’s settlement proceeds in prudent manner...not sure who is owed protector’s fiduciary duty, ie., the beneficiary or the trust itself from foreseeable injury. Court held that since protector could remove the trustee if acting against purpose of the trust, some sort of supervisory duties over trustees could be implied. Protector had a duty to monitor the trustees to make sure they acted in best interest beneficiary and since protector failed to monitor trustees, trustees were able to squander trust assets and assets were improperly depleted for over \$500,000. All this case did was allow there were sufficient elements necessary to state a claim for breach of fiduciary duty by claiming the above last items. Informing protector of trustees mishandling of assets does not constitute “bad faith”.

In re Estate of Taubman (not reported in Cal. Rptr. 3rd 2004 – (not officially published). Court did not remove trustee and relieved trustee from liability for “negligent action and inaction” and provided that good-faith reliance on trust advisors was evidence of absence of fraud and willful misconduct. (Advisors in this case were attorneys and accountants.truly were just advisors.)

City of Dubuque v. Iowa Trust, 519 N.W.2d 786, 788-89 (Iowa 1994) Trust contained a provision holding trust advisors and consultants liable to trust participants for gross negligence and reckless disregard of duties...thereby suggesting liability for consequential damages.

In re Mark K. Eggebrecht Irrevocable Trust, 300 Mont. 409, 4P.3d 1207, 2000 WL 988241, 2000 MT 189, Mont., 2000(No. 99-125) Trust was created as the result of a will

contest by Pauline and Howard. Trust was to benefit Mark Eggebrecht's two young daughters. Carla was Mark's wife; Howard and Pauline were Mark's parents. Mark died. Mark's mother (Pauline) and wife (Carla) were joint trustees (had to act jointly and could not act without other's agreement) and his mother, father, and surviving wife were also trust advisors. Some advisors had authority with respect to certain subject matters, like investments and concerning certain properties the advisors had authority to direct the trustee individually or together with other advisors. Recipe for disaster as mother and daughter-in-law could not agree on anything. Court modified the trust and appointed a corporate trustee (named in instrument as successor trustee) as sole trustee and eliminated the advisor position.

Papiernik v. Papiernik, 45 Ohio St.3d 337, 544 N.E.2d 664, 1989 WL 110783, Ohio, 1989(No.88-367.) Grantor had a trust and amended it to establish trust advisors to the trustee (his CPA and wife). Trustee could not sell, lease, exchange or reinvest assets without advisors' consent...could only approve trust transactions. Advisors had no other responsibilities to trustee but jointly could appoint a different trustee of their choice (but not a beneficiary or grantor). Each could appoint a successor advisor. Case came to court because beneficiaries sought injunctive relief against trust advisors...court removed advisors because it found one advisor (surviving wife) was guilty of misconduct but Court of Appeals reversed. (She tried to insert herself into the family business but knew nothing about the corporation said sons and tried to have a friend replace the long time CPA as the other advisor. Sons wanted her removed and were the ones who brought the case to court. Question of whether sons had standing.) Appellate court found trial court should not have modified the trust to remove position of advisors but did agree that wife misunderstood advisor position and acted irresponsibly and unsuitably in relation to the trust. Appellate court said trial court acted properly in removing wife but not in removing CPA and position of trust advisor. CPA was to appoint new advisor vacated by decedent's wife.

Stuart v. Wilmington Trust Co., 474 A.2d 121, Del.Supr., March 1984. Trustee and one of two advisors petitioned court for interpretation of trust. Other advisor, a beneficiary of the trust, had requested and consented to invasion of principal for purchase of a plane for his personal "benefit" (which would have involved selling family company stock, Carnation Co., wherein trust provisions contained strict instructions not to sell the stock. Court held beneficiary is disqualified as a fiduciary as trust advisor because of his self interest to invade principal for his own benefit. (Agency cost overtones and self dealing issues.)

Cleveland Trust C., v. Firestone., not reported in N.E.2d, 1980 WL 354378, Ohio App.8 Dist., January 19080(No. 39821). Involved what were originally 6 child advisors that had only two survive at time of transaction...instrument provided that when there are two or less remaining advisors the trustee's judgment is controlling if there's a difference of opinion between trustee and remaining advisors...concerned liquidation of company.

Crocker-Citizens National Bank v. Younger, 4 Cal.3d 202, 481 P.2d 222, 93 Cal.Rptr. 214, 56 A.L.R.3d 1228 (Cal. Feb., 1971 (No. L.A. 29703)). Held that advisors (a trust committee) with powers of direction are fiduciaries..compares them with co-trustees

Evelyn: The info below is not part of outline...just there for me to refer to.

XXII. Conclusion:

- A. The position of trust protector can be uniquely useful/worth consideration when flexibility and outside advice are desired
- B. Explaining the idea of using a protector can be enough to overcome the reluctance by some persons in need of a trust arrangement
- C. One shouldn't get overly carried away with the concept of protectors, however, in the context of perpetual trusts
 - 1. Is it really possible to draft for all circumstances for 100 years into the future, let alone 1,000 years down the road?
 - 2. Estimates conclude that an average married couple with 2.1 children would have:
 - more than 100 descendants 150 years after a trust is created,
 - producing approximately 2,500 beneficiaries 250 years after the trust is created,
 - 45,000 beneficiaries 350 years into the trust, and
 - 3.4 million beneficiaries after 500 years

How does even the most thoughtful of settlors and the most clever of attorneys plan for this? Is a trust protector and his successors the answer?

Can trustee act if protector does not overtly answer?... what happens when protector does not respond? This may be solved by having a time limit 20 or 30 days. Are all of the trustee's transactions subject to the protector's veto...perhaps best to seek approval only for more significant transactions such as closely held business property, specific dollar amounts, real estate, etc.

What about "blanket consent" until protector withdraws consent?

No readily available metric for evaluating the protector's actions or inactions...rarely is there strong evidence of the settlor's wishes..that's why a protector was appointed. Remember, the settlor reposed his confidence in the protector, not in a reviewing court. **What the settlor expects from the protector is a reasonable exercise of judgment,,if doctrine expects much more, protectors will be hard to find.**

Clafin Material PurposeRule: denies termination of a trust ahead of time even when beneficiaries unanimously consent after settlor's death, if termination would contravene a material purpose of the settlor (and then only with court approval unless trust provides/allows for beneficiaries to agree). Cases where the settlor and all beneficiaries wish to modify or terminate a trust are rare...usually it's after the settlor is deceased. If all that's required is by unanimous consent, court approval is not required. If settlor is represented by another (conservator, protector), additional requirements have to be met

Equitable Deviation Doctrine (Unanticipated Circumstances Doctrine) (a bit like *Cy Pres* that's applied to charitable trusts): when circumstances unanticipated by settlor occur, the court may modify the administrative terms of the trust but only to prevent the unanticipated circumstances from defeating or substantially impairing the accomplishment of trust purposes.

State Decanting Statutes: Seven states have enacted statutes permitting a trustee with discretion to distribute principal of a trust to exercise the discretion by transferring principal to a new trust, which may have terms different than the original trust. (Alaska, DE, FL, New Hampshire, NY, S. Dakota, and Tennessee).

Conclusion:

The position of trust protector can be uniquely useful and is well worth consideration when flexibility and outside advice are desired. A trust advisor can be an extremely useful person in assisting the trustee to decide questions that may have highly personal overtones, such as the retention or voting of closely held corporation stock, decisions with reference to investments or problems concerning discretionary distributions to family members. Explaining the idea of using a protector can be enough to overcome the reluctance by some persons in need of a trust arrangement. One shouldn't get overly carried away with the concept of protectors, however, in the context of perpetual trusts.

Is it really possible to draft for all circumstances for 100 years into the future, let alone 1,000 years down the road?

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