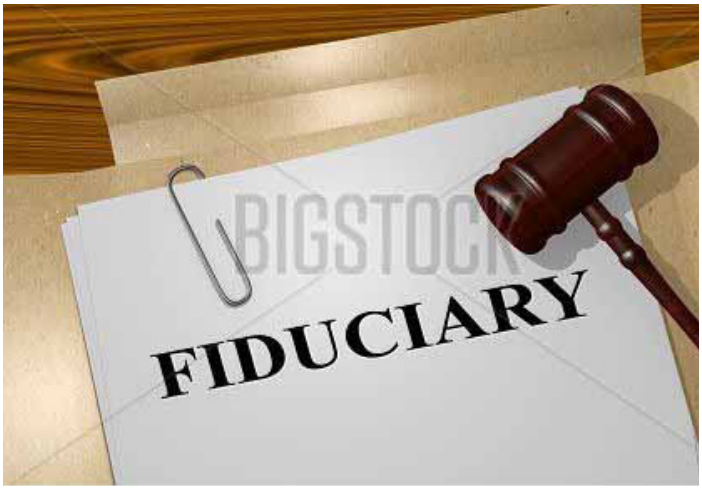
ARKANSAS ENACTS A VERSION OF THE UNIFORM DIRECTED TRUST ACT: RELIEF FOR "DIRECTED TRUSTEES" BEGINS IN 2020

By David Biscoe Bingham



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Being a trustee means complying with the highest applicable standard of duty under the law—fiduciary duty. A person who stands in a fiduciary relationship over another person cannot act, or fail to act, in a way that harms the beneficial interests of the fiduciary's charge. (This "charge" can be called a ward, beneficiary, or many other things depending on the specific office of the fiduciary.) This article, in dealing with the Uniform Directed Trust Act (the "Uniform Act" or the "Act"), will focus on the fiduciary relationship between trustees, non-trustees, and the beneficiaries of a trust.

In recent years, it has become more common for trusts to grant multiple parties various powers over trust property. Of course there is still a trustee, owing the classic fiduciary duty to the beneficiaries. But now, trusts increasingly provide for non-trustees (often called "trust protectors" or "trust directors") to have power over some aspect of trust administration—such as the trust's investment strategy or the management decisions for a family business owned by the trust. Increasingly too, trust beneficiaries are requesting that non-trustees be given responsibility for some aspect of trust administration, and sometimes they even want to modify the trust to allow for such an approach. This all stands in contrast to the traditional approach of centralizing trust power, with its attendant fiduciary duty, in one trustee.

When these non-trustees exercise their power as non-trustees, to whom do they owe fiduciary duty? Do they owe any fiduciary duty? What if the trustee disagrees with the non-trustee's decision or believes it could harm the beneficiaries? Not to mention the instances

where trustees and non-trustees have been sued by beneficiaries for the bad investment decisions or improper utilization of trust assets by a non-trustee.[1] Sometimes the beneficiaries actually win these lawsuits.[2] Understandably then, there needs to be some clarity in the law for situations where a trust instrument grants trustees and non-trustees various powers over trust property, or where a trust has beneficiaries that insist on keeping the same investment manager around as a non-trustee.

Enter the Uniform Act. First introduced by the Uniform Law Commission in 2017, the Uniform Act is designed to solve the problems that arise where the trust instrument itself grants powers to a third party other than the trustee, and that third party non-trustee (who is termed a "trust director" under the Act) exercises (or fails to exercise) those powers. Since being introduced, the Uniform Act has been adopted by 10 states[3] in multiple regions of the country.

The Arkansas Legislature, via Act 1021 of the 2019 Regular Session, adopted Arkansas' version of the Act (the "Arkansas Act") with an effective date of January 1, 2020. The Arkansas Act tracks the Uniform Act almost verbatim except for two minor differences and one major difference. The Act contains 20 sections; but, as is common in all the uniform acts, some of these sections are technical provisions. In the Uniform Act, Sections 2, 3, 5 11, 13, 15, & 16 are the substantive sections. The same is true in the Arkansas Act, but the corresponding sections bear their final codified section numbers as set out in the Arkansas Code.

Section 2 is the first substantive section and contains the definitions used in the Uniform Act. These definitions contain some new innovations and clarifications to address the difficult problems mentioned above.

For instance, Section 2(1) of the Uniform Act expands "breach of trust" to cover trust directors, as well as trustees, who violate any duty imposed on them by the terms of the trust. With this expanded definition (as well as other provisions in the Act) trust directors who exercise their powers under a trust now owe a fiduciary duty to the trust beneficiaries in the exercise of those powers, the same as if those trust directors were serving as trustees themselves.

Another key definition is found in Section 2(5) of the Act. This provision defines a "power of direction" as any power granted by a trust instrument to a person who is not serving as trustee when they exercise the granted power. Before you start thinking about how this would work with powers of appointment and the trust grantor's power of revocation, Section 2(5) excludes these, and a list of other powers in Section 5(b), from being powers of direction. With this broad and innovative definition, the Act recognizes what most drafters know and some legislatures eventually discover—there is always some way to create a new power in a trust.

Section 2(8) expands the definition of "terms of a trust" to include not just the express written words of the trust, but the meaning of a trust as established by subsequent court orders and non-judicial settlement agreements. Both court orders and non-judicial settlement agreements are authorized under the Uniform Trust Code[4] and are increasingly common ways in which trusts are modified from the grantor's original written direction.

Section 2(9) defines "trust director" to mean any person who is granted a power of direction, by the terms of a trust, exercisable as a non-trustee. Combined with the expansive definition of a power of direction in Section 2(5), the only limits to creating a trust director via the terms of a trust are: 1) the drafter's imagination, 2) making sure that person is not a trustee already, and 3) Sections 5(b), 6, and 7 of the Act, which will be discussed shortly.

Section 3 clarifies that the Act only applies to actions which are taken after the Act's effective date,[5] where the trust has its principal place of administration in the enacting state, or to actions taken after a trust has moved its principal place of administration to the enacting state (subsequent to the effective date, of course). Section 3(b) provides two "safe harbors."[6] These "safe harbors" are objective facts that, when added to a trust stating its principal place of administration, conclusively establish that principal place of administration. This is the first area in which the Uniform Act and the Arkansas Act part ways—the Arkansas Act drops the safe harbor for trust directors.

Section 5(b) contains an important list of exclusions from the "power of direction" definition found in Section 2(5). These exclusions are: powers of appointment, power to appoint or remove a trustee or trust director, power of a grantor to revoke the trust, power of a beneficiary to affect his or her own beneficial interest, and power given to a non-fiduciary for tax purposes.

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The drafters of the Uniform Act made the commonsense choice to exclude these powers because each power has its own accumulated law and including these powers as "powers of direction" (thereby turning their exercisers into trust directors) would have created worse problems than the Act was supposed to solve. For instance, what if a grantor, desiring to revoke his or her trust, was then determined to be a trust director? This would mean he or she owed a fiduciary duty to the beneficiaries (all of them) in revoking the trust. This result flies in the face of current law and would be a serious disincentive for any grantor desiring to create a trust in the first place.

Section 6 establishes the boundaries for any possible power of direction that a trust instrument could grant. Those boundaries are…pretty much anything a trust can be created for in the first place (and that a drafter can come up with), as long as it's not listed in Section 7. (The drafting committee did include a list of "contemplated powers" in the comments to Section 6, which are some of the common powers given to the typical trust director.)[7]

Section 7 contains two important policy areas that all powers of direction (and thereby trust directors) are subject to—Medicaid payback and state regulation of charitable trusts. Although not stated in the official comments, it is likely this section was included (at least in part) to check the enterprising drafter who may attempt to grant a trust director power to quash a Medicaid payback or charitable notice provision. Oth-

er than these two areas, basic trust formation law, and the list of excluded powers in Section 5(b), there is no limit on the creativity of trust drafters to design new powers of direction under the Act.

Section 8 contains one of two cornerstones in the Uniform Act. Under this section, a trust director, in the exercise or non-exercise of his or her power of direction, has the same fiduciary duty (and thus liability) to the beneficiaries that a trustee would in a similar position under current law. This section is where the Act expands the fiduciary duties owed to the beneficiaries to all trust directors, the same as trustees. Section 8(b) is a notable carve-out. Under this section, fiduciary duty and liability do not attach to a healthcare professional acting within the course and scope of his or her healthcare profession, *unless the terms of the trust provide otherwise*. The comment to this section conveys the drafting committee's concern that a healthcare professional might decline to serve as a trust director if he or she would be exposed to a fiduciary standard in performing healthcare work.[8] The addition of the "terms of the trust" clause means that any healthcare professional asked to serve as a trust director would be well-advised to read the trust first.

Section 9 is the other cornerstone of the Act and where the major difference between the Uniform Act and the Arkansas Act occurs. The Arkansas Legislature declined to adopt the Uniform Law Commission's "willful misconduct" standard for a trustee (termed a "directed trustee" when the non-trustee trust director is, well, directing that trustee). Remember, under the Uniform Act a trust director now owes a fiduciary duty to the beneficiaries, but where does this leave the "directed trustee" while the trust director is acting? The Uniform Law Commission considered the various states' standards and finally decided that as long as the trustee did not engage in willful misconduct with respect to a trust director's action, the trustee should be protected from liability for the harmful actions of the trust director. This is the approach that is used in Delaware,[9] Illinois, Texas, and Virginia, with Delaware's experience and approach particularly influencing the Commission.[10] Of course, this approach would still leave a core of fiduciary duty, with its attendant liability (the key word), in the "directed" trustee.

Directed trustees have reason to feel even less nervous in Arkansas. Although they must take reasonable action to comply with a properly acting trust director, under the Arkansas Act's version of Section 9,[11] *unless the terms of the trust provide otherwise*, the directed trustee **is not liable for**:

1. Any loss that results directly or indirectly from any act taken or omitted as a result of the reasonable action of the directed trustee to comply with the direction of the trust director or the failure of the trust director to provide consent; and
2. Whenever a directed trust reserves to a trust director the authority to direct the making or retention of any investment, to the exclusion of the directed trustee, […] any loss resulting from the making or retention of any investment under such direction.

Arkansas' codified Section 109(b)[12] provides added protection. Under it, *unless the terms of the trust provide otherwise*, any actions the directed trustee takes to comply with the directions of a trust director, *if those directions are within the scope of that trust director's powers*, are considered administrative actions. Administrative actions, under the language of Section 109(b), do not cause the directed trustee to participate in or accept any fiduciary responsibility for the actions of the trust director. The summary is, under the Arkansas Act's version of Section 9, the directed trustee isn't liable for any loss to the trust beneficiaries when a trust director is properly exercising his or her power, and the directed trustee's actions following a trust director's direction don't carry with them any fiduciary duty to those trust beneficiaries (which means no fiduciary liability either).

With this Section 9 as enacted in Arkansas, if a trust director is involved, there really isn't liability exposure for a directed trustee. But what about the ability to vary that liability exposure in the terms of the trust? This is where Arkansas' codified Section 109(c)[13] comes in. Section 109(c) requires any party seeking to hold a directed trustee liable under this section to prove the matter by clear and convincing evidence—the highest evidentiary standard in civil law. Of course, since Section 109(a) already plainly provides that the directed trustee is not liable, this provision only kicks in where a trust's terms expose the directed trustee to liability by overriding the default provisions found in 109(a). Clearly, there was reason for any directed trustees in Arkansas to have had a Happy New Year. The only thing they now have to watch out for, under the Arkansas Act, is the wily drafter or grantor who attempts to hold them liable via the trust instrument itself. And if such an instrument should slip through and expose the directed trustee, the (potentially) harmed beneficiaries of such a trust still have a high threshold to clear.

With this major change to the text of the Uniform Act as enacted here, Arkansas really does hew closer to states like Missouri,[14] New Hampshire,[15] South Dakota,[16] Nevada, and Alaska that do not maintain any "core of liability" in the directed trustee. In fact, Arkansas' codified Section 109 borrows quite closely from the language of the Missouri statute. Further, the "clear and convincing evidence" bar is also found in Missouri, New Hampshire, and South Dakota.

So, although Arkansas is considered a state that has adopted the Uniform Act,[17] in practice, it really has the "no duty, full reliance" standard adopted by Missouri, et al. The Uniform Law Committee considered this approach, but ultimately rejected it, as the Committee felt the directed trustee was still a "fiduciary" who had some minimum level of continuing duty, even while a non-trustee was exercising powers granted by the trust.[18]

Sections 10 and 11 of the Uniform Act deal with the flow of information between the trustee, the trust director, and the beneficiaries. Section 10 also contains the last difference between the Uniform Act and the Arkansas Act. Under Section 10, the trustee and trust director are supposed to share information, and each has no liability for any breach of trust as long as the breach resulted from reliance on the information of the other. The Uniform Act added "unless by so doing the trustee (or trust director) engages in willful misconduct." Arkansas declined to adopt this language,[19] consistent with its choice against the Act's willful misconduct standard.

Section 11 straightforwardly provides that the trustee and trust director do not have a duty to monitor each other or report to the beneficiaries if they believe anything to be amiss with the other's actions. It further provides that if the trustee or the trust director do monitor or report on each other,

by so doing they do not assume any fiduciary duty. This provision seems necessary to prevent a plethora of "you should have told me" arguments and essentially tear down the liability shield the Act creates between trustees and trust directors for the actions of the other. Practically, however, it has now shifted the risk for failing to stay informed. Once again a version of the old common law adage applies: "Let the beneficiary beware."

Sections 13 and 16 conform the office of trust director to the Uniform Trust Code,[20] while Section 15 provides that any person who accepts appointment as a trust director is submitting himself or herself to the personal jurisdiction of the courts of the enacting state for any matter related to the exercise of his or her powers or duties. Out-of-state investment advisors who happen to read this article and think they are safe so long as they administer the trust's investments from their office might want to take note.[21]

The most controverted issue addressed in the Act was the fiduciary standard for a directed trustee. Under the Restatement,[22] Uniform Trust Code,[23] and prior Arkansas law[24] (for actions before December 31, 2019), a directed trustee has to follow a trust director's directions unless the action would be "manifestly contrary to the terms of the trust" or the trustee knows the action would constitute "a serious breach of fiduciary duty" that the trust director owes to the beneficiaries. This standard has been unpopular with most of the states and creating an alternative was one of the reasons the Uniform Act was introduced.

Arkansas has adopted the Uniform Act but, somewhat ironically, adopted the standard for directed trustee liability that the Uniform Law Committee rejected. Only time will tell if this standard is the better one for beneficiaries than the standard proposed in the Uniform Act. What is certain is that directed trustees in Arkansas had a good start to 2020. Hopefully, the standards set forth in the Arkansas Act, and by Uniform Act overall, will create greater certainty in this area of the law. And, by so doing, create more opportunity for trust grantors and drafters to incorporate powers of direction into their trusts.

Endnotes:

1. *Guinan v. Block*, No. HHD-CV126041243S, 2015 WL 601356, (Conn. Super. Ct. Jan. 23, 2015); *Robert T. McLean Irrevocable Tr. v. Patrick Davis, P.C.*, 283 S.W.3d 786 (Mo. Ct. App. 2009).
2. *Rollins v. Branch Banking, Tr. Co. of Va.*, 56 Va. Cir. 147 (2002).
3. Arkansas, Colorado, Connecticut, Georgia, Indiana, Maine, Michigan, Nebraska, New Mexico, & Utah.
4. As adopted in Arkansas, Ark. Code Ann. § 28-73-101 *et seq*.
5. In Arkansas the effective date is January 1, 2020.
6. Safe Harbor 1—the trustee's principal place of business is in the enacting jurisdiction, or the trustee is a resident of the enacting jurisdiction. Safe Harbor 2—the trust director's principal place of business is in the enacting jurisdiction, or the trust director is a resident of the enacting jurisdiction.
7. Uniform Directed Trust Act § 6 cmt. (2017). Some of the more notable powers listed are: The power to direct investments; the power to modify, reform, terminate, or decant a trust; the power to change the principal place of administration; and the power to determine the capacity of a trustee, grantor, director, or beneficiary of the trust.
8. Uniform Directed Trust Act § 8 cmt. (2017).
9. Del. Code ann. tit. 12, § 3313.
10. Uniform Directed Trust Act § 9 cmt. (2017).
11. 2019 Arkansas Laws Act 1021, § 5, Ark. Code Ann. § 28-76-109.
12. *Id.*
13. *Id.*
14. Mo. Ann. Stat. § 456.8-808.
15. N.H. Rev. Stat. Ann. § 564-B:12-1205.
16. S.D. Codified Laws § 55-1B-2.
17. Uniform Law Commission–Directed Trust Act Enactment: https://www.uniformlaws.org/committees/community-home?CommunityKey=ca4d8a5a-55d7-4c43-b494-5f8858885dd8 (last accessed October 31, 2019).
18. Uniform Directed Trust Act § 9 cmt. (2017).
19. 2019 Arkansas Laws Act 1021, § 5; Ark. Code Ann. § 28-76-110(c) & (d).
20. As enacted in Arkansas, Ark. Code Ann. § 28-73-101 *et seq*.
21. *See Matter of Beatrice B. Davis Family Heritage Tr.*, 133 Nev. 190, 394 P.3d 1203 (2017).
22. Restatement (Third) of Trusts § 75 (2007).
23. Uniform Trust Code § 808 (2000).
24. Ark. Code Ann. § 28-73-808 (as in effect prior to January 1, 2020).