



MEMORANDUM

From: Commissioner Robert H. Sitkoff, Chair
Commissioner Turney Berry, Vice-Chair
Professor John D. Morley, Reporter

To: Members, Advisors, and Observers
Drafting Committee for an Act on Divided Trusteeship

Re: Third Meeting (April 1-2, 2016)

Date: March 15, 2016

This memo provides an overview of the status of our project as we head into our third drafting session, to be held in Chicago on Friday and Saturday, April 1 and 2. It also provides a brief overview of important changes to the “discussion draft” since the last meeting and takes note of some further issues for discussion.

The upcoming meeting will be the third of what is planned to be five in-person drafting sessions (on Friday night, we can celebrate having reached the halfway mark). After our upcoming meeting in Chicago, we will read our act at the Annual Meeting of the Uniform Law Commission, to be held in Stowe, Vermont, in July. Depending on the nature of the revisions indicated by our discussion in Chicago, we might ask for a conference call to discuss discrete issues before finalizing the Annual Meeting draft.

Looking further ahead, we are scheduled to meet again in Fall 2016 and in Spring 2017. After the Spring 2017 meeting, we will read a proposed final version at the Annual Meeting in Summer 2017, to be held in San Diego, at which the Commissioners will be asked to approve the act subject to further amendments made at that meeting.

The remainder of this memo augments the discussion notes embedded within the draft by flagging several important changes since the last draft and pointing to some further issues for discussion.

1. *Name change.* Per our discussion at the last meeting, Section 1 shows an alternative title of “Directed and Divided Trusteeship Act.” The discussion note surveys the basic pros and cons as well as the further alternative of “Directed Trusteeship Act.” A name change requires approval of the Executive Committee. If the consensus favors a name change, we will undertake to obtain approval before the Annual Meeting.

2. *Definition changes.* As canvassed in the discussion notes to Section 2, there is a new defined term (“breach of trust”), several definitions have been reworked, and one, “vacancy in a trust directorship,” has been deleted. The vacancy definition has been deleted because in this draft the term no longer requires a definition (see also point 5 below).

The term “trust director” no longer excludes a holder of a nonfiduciary power of appointment, instead such a power is excluded from the scope of this act by Section 5, which is new. The term “trust director” once again excludes a trustee, so that a trustee cannot be a trust director, instead application to cotrustees is addressed by Section 12 (see point 7 below).

The term “terms of a trust” has been revised to address a variety of technical issues, including the possibility of revision by a trust director using a power of protection to amend the terms of the trust.

An open question for discussion, raised in the discussion notes to Section 2, is whether the term “trust director” should be limited to exclude a corporate entity that is not otherwise authorized to hold trust powers. Another open question, raised in the discussion notes to Section 10, is whether to include a definition of “willful misconduct” (see point 6 below).

3. *Additional categories of powers, but no residual.* Section 6 provides for a reworked classification of powers that may be granted to a trust director. In addition to powers of “direction,” “consent,” and “protection,” as under the prior draft, this draft also includes a power of “approval or ratification,” and a power of “selection.” The guiding principle of the new arrangement is practical rather than theoretical. We grouped powers together based on the way they are addressed in subsequent provisions. The new categories thus allow for greater specificity by type of power in the fiduciary duties of the trust director (Section 8), the powers of a directed trustee (Section 9), and the fiduciary duties of a directed trustee (Section 10).

Section 6 does not include a residual category. For the reasons given in the discussion notes, we could not make such a category work. Section 6 also does not include a tax planning category. Instead the problem of powers that for tax planning reasons should not be fiduciary is addressed by new Section 8(d) (see point 4 below).

The incidental further powers of a trust director, which had been included in the same section as the director’s expressly granted powers, is now addressed by Section 7. Separating express and incidental powers provides further simplifies the act.

4. *Fiduciary duties of trust director.* The fiduciary duties of a trust director are governed by Section 8, which has two significant changes since the last draft. First, Section 8(c) provides a carve out for a licensed medical professional acting in his or her capacity as such. Second, Section 8(d) provides a carve out from fiduciary status for a trust director “if exercise or nonexercise of the [director’s] power in a fiduciary capacity will or

may deprive the trust of a tax benefit or impose a tax burden contrary to the settlor's actual or probable intent." Both of these changes are examined in the discussion notes.

An open issue for discussion, raised in the discussion notes to Section 8, is whether a power of selection to appoint or remove a trustee or another trust director, or a successor to either, should be categorically excluded from fiduciary status, or if instead the combination of the tax carve out in Section 8(d) plus the malleability of the "good faith" standard in Section 8(b) is sufficient. A related issue, also examined in the discussion notes, is whether the context-sensitivity of "good faith" is sufficient to address the difference between exercise and nonexercise of a power.

5. *Disempowerment of directed trustee and vacancy in trust directorship.* Section 9 carries forward the rule of disempowerment of a directed trustee. Unlike the prior draft, however, this draft continues to disempower the trustee even if the trust director is unavailable or the trust directorship is vacant. The discussion notes examine this issue, which we will discuss at the meeting, in further depth.

6. *Fiduciary duties of directed trustee – herein of "willful misconduct."* One of the more significant policy changes in this draft is in Section 10. In contrast to the prior draft, which completely exonerated a directed trustee to the extent the trustee acted at the direction of a trust director, Section 10 applies Delaware's "willful misconduct" standard. The discussion notes examine the arguments pro and con and raise a host of follow up technical questions for further discussion.

7. *Application to cotrusteeship.* Another significant change since the prior draft is the treatment of cotrustees. The prior draft replaced the traditional law of cotrusteeship with the more permissive rules of this act for any cotrusteeship in which one trustee had a power of a trust director over another cotrustee. By contrast, under Section 12 of this draft, the default rule is that, if the settlor names cotrustees, the traditional law of cotrusteeship applies. However, the terms of the trust can provide instead that the duties and liabilities of a trust director and a directed trustee apply to the cotrustees. Section 12 also includes further bracketed transition language. The specifics of these changes are canvassed in the discussion note.

8. *Return to absorption in mechanical provisions.* At the last meeting the consensus was that the various technical provisions on litigation and the office of trust director, which had been reworked to follow the Uniform Trust Code, should go back to the strategy of absorbing the enacting state's law applicable to a trustee. Sections 14-15 and 17 implement that instruction.

9. *Legislative notes and conforming amendments to the Uniform Trust Code.* The discussion notes to several sections raise the question of possible conforming amendments to the Uniform Trust Code or adding a legislative note with directions to that effect. At the meeting we should take up this question systematically as we consider each section that touches on a provision in the Uniform Trust Code.

10. *Mandatory and default rules.* At the last meeting the consensus was that in preparing this draft, we should focus on the mandatory versus default character of each provision, and make that character clear either by freestanding section modeled on Uniform Trust Code § 105 or in the text to each section. In this draft, the sections that are default – that is, the sections that state rules that may be varied by the terms of a trust – are express in acknowledging their default character. There is sporadic mention of this issue in the discussion notes. We should consider this issue systematically at the meeting.