Estate Planning with Directed Trusts under the Colorado Uniform Directed Trust Act

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This article explains directed trusts and how they operate under the Colorado Uniform Directed Trust Act. It includes tips for drafting directed trusts and advising fiduciaries.

Estate planners are familiar with creating trusts to prudently manage and safeguard their clients' wealth. Clients generally understand the benefits of a trust as a tool for achieving a host of planning goals. But many clients are averse to the idea of hiring a professional, non-family member trustee to manage their wealth, even though a professional may better serve their needs. In addition, attorneys often fail to advise their clients about the risks of appointing a non-professional trustee. Such risks include a trustee who steals from the trust, a trustee who fails to exercise independent discretion (and thus subjects the trust to estate or generation skipping transfer tax inclusion), and litigation initiated by beneficiaries who simply don't like the family member trustee.

A directed trust allows trust settlors to involve family members in the administration of a trust when appropriate, but to use professionals to ensure compliance with fiduciary duties, provide professional investment management, deal with contentious beneficiary relationships, manage complex assets, and provide independent judgment with respect to discretionary distribution decisions.

This article explains directed trusts and discusses

- how directed trusts differ from other common trust structures;
- when to use a directed trust in an estate plan;

- how directed trusts operate under the Colorado Uniform Directed Trust Act (CUDTA or the Act);
- drafting and practical considerations; and
- advising fiduciaries serving under a directed trust.

Distinguishing a Directed Trust

In a directed trust arrangement, the powers and fiduciary duties ordinarily vested in a trustee or equally among co-trustees are allocated to one or more "trust directors" and one or more "directed trustees." Under the Uniform Directed Trust Act (UDTA), a trust director has the power to direct a directed trustee in the performance of a specific function or functions, and the directed trustee must comply with such direction. The directed trustee either lacks or has diminished authority to act regarding the functions allocated to the trust director. Accordingly, the directed trustee's fiduciary duty and, therefore, potential liability are reduced.

The Delegated Trust

In a delegated trust arrangement, the trustee contracts with a third party to perform certain functions on behalf of the trustee. The third party acts as the trustee's agent, subject to the terms of the contractual relationship.[1] The trustee must exercise due care in selecting the party to whom the functions are delegated and maintains an ongoing fiduciary duty to supervise that party and monitor his or her conduct.[2] The trustee retains authority to act with respect to the functions delegated, so he or she cannot avoid fiduciary duty and the potential liability that follows it. This differs from a directed trust, in which the directed trustee does not exercise any powers regarding the trust director's functions, and thus the duties and liabilities shift from the trustee to the trust director.

The Co-Trusteeship

In a co-trusteeship, the co-trustees' powers and duties are generally held jointly. Co-trustees are authorized to act in concert with respect to all trust functions, and therefore each must discharge all fiduciary duties. Thus, co-trustees generally remain fully liable for any breaches of trust, even if a breach resulted from the action of one co-trustee. Conversely, a directed trustee is generally not liable for complying with a trust director's direction or for a trust director's independent actions; a directed trustee simply complies with the trust director's instructions and, accordingly, is divested of power with respect to the trust director's functions.

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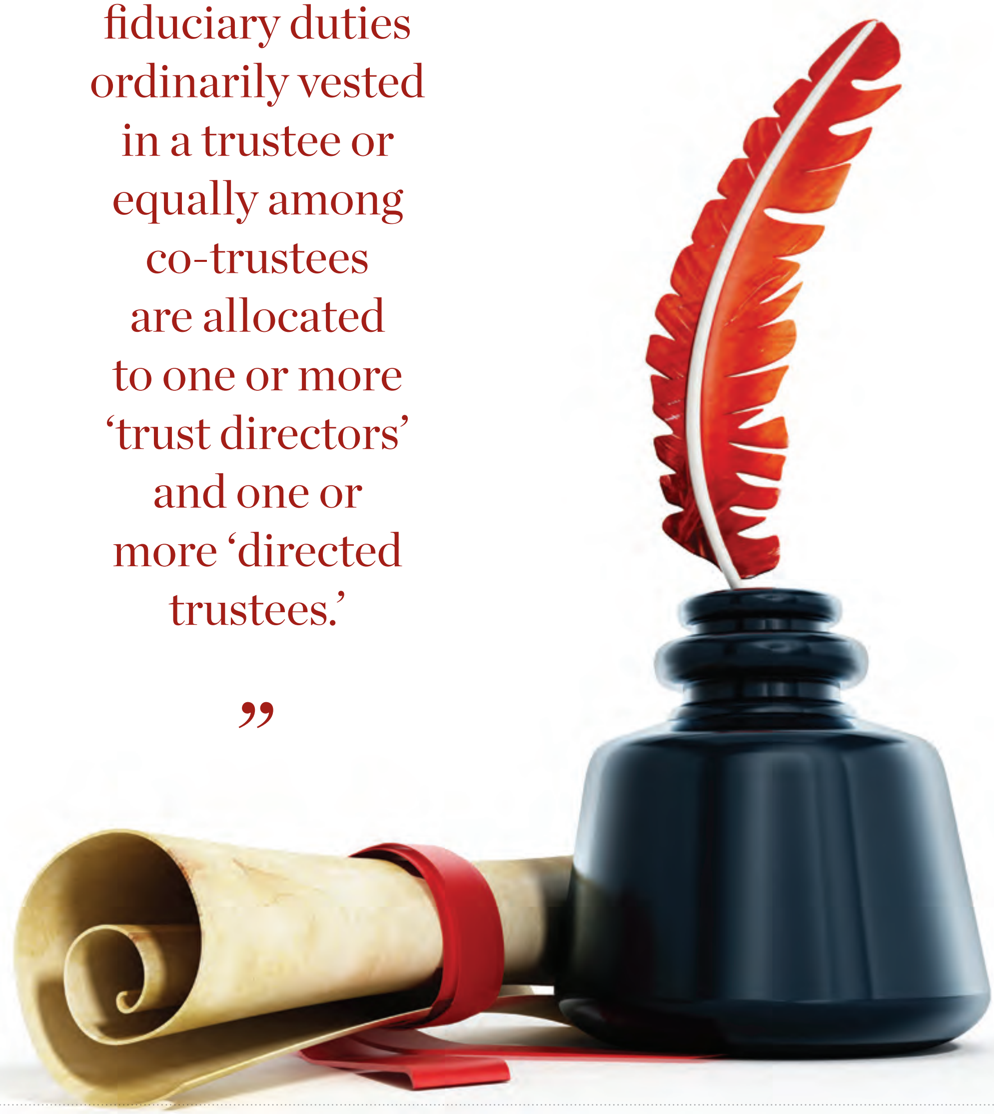
History of Delegated Trusts

Historically, a trustee's authority to delegate functions was limited. In fact, a trustee had a duty *not* to delegate to others the doing of acts that the trustee could reasonably be required to perform personally.[3] For example, in *In re Will of Hartzell*, a trustee delegated the power to hold the proceeds from the sale of trust property to the trustee's attorney, and the attorney absconded with the funds.[4] The court found that the trustee's delegation was improper and, therefore, the trustee breached its fiduciary duty and was liable for the loss to the trust estate.[5] In so holding, the court relied on the general principle that while a trustee may delegate purely ministerial powers or duties, a trustee may not delegate powers and duties involving an exercise of judgment and discretion.[6]



The limits of a trustee's authority to delegate have been relaxed in recent years. For example, the Colorado Fiduciaries' Powers Act, CRS §§ 15-1-804 et seq., and the Uniform Prudent Investors Act, CRS §§ 15-1.1-109 et seq., specifically empower a trustee to delegate certain functions. However, both acts follow the *Restatement (Third) of Trusts*' approach, that a delegation is proper only if a prudent person of comparable skill would delegate the responsibilities to others.[7] In addition, the delegating trustee has the duty to exercise fiduciary discretion in deciding whether, to whom, and in what manner to delegate fiduciary authority in the administration of a trust.[8]

History of Directed Trusts

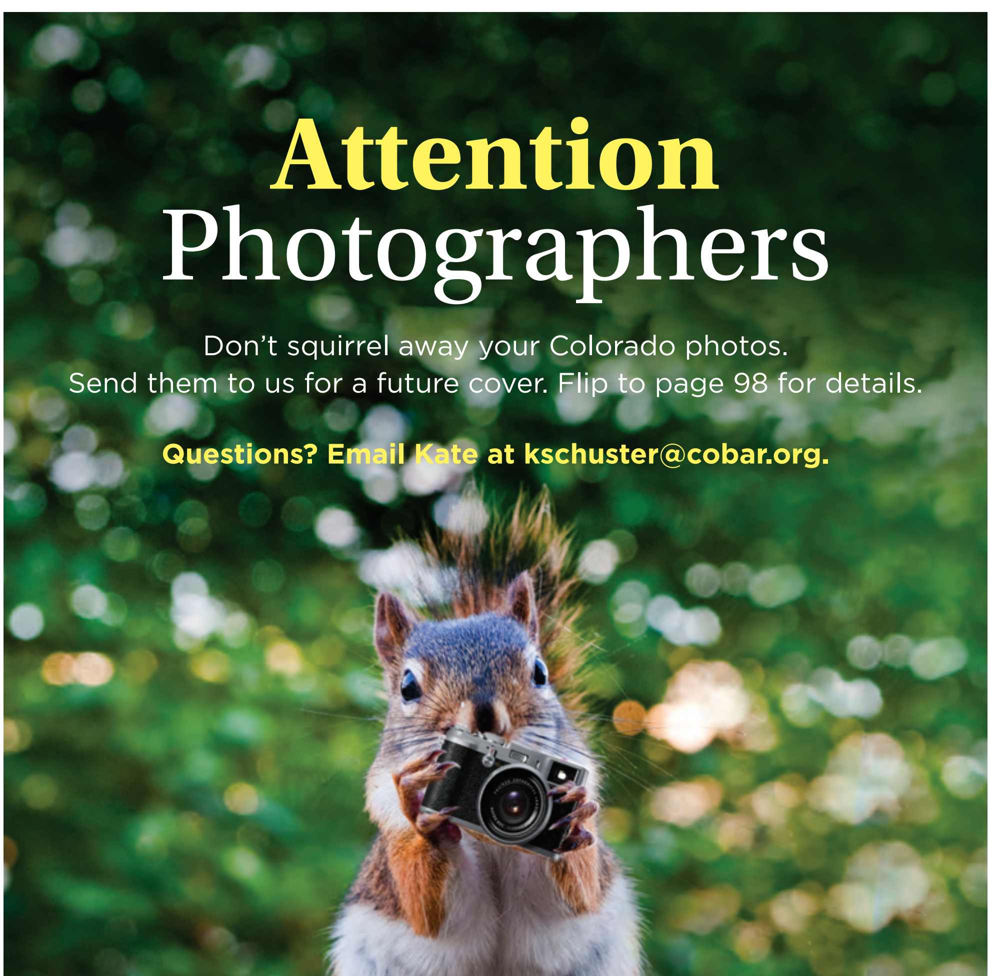
Common law recognizes directed trust arrangements but imposes on directed trustees the duty to monitor the actions of trust directors. For example, section 75 of the *Restatement (Third) of Trusts* provides:

> [Generally], if the terms of a trust reserve to the settlor or confer upon another a power to direct or otherwise control certain conduct of the trustee, the trustee has a duty to act in accordance with the requirements of the trust provision reserving or conferring the power and to comply with any exercise of that power, *unless the attempted exercise is contrary to the terms of the trust or power or the trustee knows or has reason to believe that the attempted exercise violates a fiduciary duty that the power holder owes to the beneficiaries*. (Emphasis added.)

Thus, at common law, a directed trustee has a duty to comply with a trust director's direction, but the trustee retains a significant fiduciary duty: before complying, the trustee must interpose his or her own judgment to determine whether doing so would contradict the terms of the trust or violate any fiduciary duty that the trust director owes to the beneficiaries. A directed trustee cannot avoid a trustee's responsibilities, even with respect to functions specifically within the purview of a trust director. The CUDTA, like most modern directed trust statutes, alters this regime through a default rule that eliminates the trustee's duty to monitor the actions of a trust director.[9]

While case law interpreting such statutes is sparse, there are two seminal cases on the subject. The first case, *Duemler v. Wilmington Trust Company*, stands for the proposition that a directed trustee is not liable for the actions or inactions of a trust director if the trustee does not engage in willful misconduct.[10] In *Duemler*, a sophisticated investment advisor was given the express power to direct the corporate trustee with respect to all trust investments. The trustee forwarded a prospectus relating to certain investments to the advisor while the advisor was on vacation, so the advisor did not receive the prospectus and thus took no action. Thereafter, the investments to which the prospectus related declined in value. The advisor sued the trustee, claiming that the trustee breached its fiduciary duty by not providing the advisor with timely financial information. The Court of Chancery of Delaware issued an unpublished order finding no willful misconduct and exonerating the directed trustee.[11] This holding is consistent with the CUDTA's willful misconduct standard.

The second case, *Rollins v. Branch Banking & Trust Co. of Virginia*,[12] provides a cautionary tale for directed trustees who rely on a directed trust statute that is silent regarding a trustee's duty to warn beneficiaries. In *Rollins*, a trust conferred the power to retain, sell, or purchase investments exclusively on the beneficiaries. The beneficiaries directed the trustee to hold concentrated positions in certain stocks. Twenty years later, at the beneficiaries' direction, the directed trustee sold the stocks for a fraction of their original value. The beneficiaries sued, claiming the directed trustee failed to diversify and to warn them of the declining value of the stock. The court held that the directed trustee was not liable for the loss caused by the retention of stock as directed by the beneficiaries, which



is consistent with a directed trust arrangement. However, the court did not dismiss the beneficiaries' claim that the directed trustee breached its duty to warn them about the deteriorating condition of the trust investments. Specifically, the court noted that "a trustee has a duty to fully inform beneficiaries of all facts relevant to the subject matter of the trust which come into the trustee's knowledge and which are material for the beneficiary to know for the protection of his interests."[13] The fact that the directed trustee had no power over the investments did not absolve its duty to inform and warn the beneficiaries of facts, such as the decrease in value of assets, which would allow them to protect their interests. Subsequent to *Rollins*, the Virginia legislature amended its directed trust statute to relieve the directed trustee from the duty to warn. As explained below, a holding like that in *Rollins* should not occur under the CUDTA.

When to Use a Directed Trust

A directed trust arrangement is suitable for many situations, particularly where a settlor wishes to allocate the investment, distributive, and/or ministerial functions among one or more parties.

For example, a settlor may have a long-standing relationship with a professional investment advisor. The settlor might want the professional to manage trust assets but not assume any other trustee's duties. In this situation, a directed trust structure has the advantage of allowing a change of the trust's investment manager (e.g., for chronically underperforming a relevant benchmark or failing to communicate effectively with beneficiaries) without having to replace the trustee, who may be performing his or her duties well and with whom the beneficiaries may have a strong relationship.

A directed trust may also be useful where a trust will be funded with unmarketable or illiquid assets, such as real estate or a closely held business. The settlor may wish to appoint one or more trust directors with particular expertise to have authority over those assets. This authority could include not only the power to manage the assets day to day, but also responsibility for obtaining proper valuations and/or deciding whether the assets should be retained in the trust. Naming a trust director for complex assets might also be appropriate if a corporate fiduciary that serves as trustee is not keen on assuming responsibility for such assets, or would charge hefty fees for doing so. The trustee would be a directed trustee as to those specific holdings over which the trust director has authority but would retain full discretion over the trust's other assets.

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Further, settlors often want to vest distribution decision-making authority in one or more persons who have knowledge of the trust's beneficiaries and their circumstances but allocate all other fiduciary functions to a professional trustee. Here, a directed trust arrangement allows the settlor to allocate the distributive functions to family members or close family friends while allocating the burden of other duties, such as prudently investing trust assets, to a professional. Alternatively, a settlor may wish to allocate certain ministerial duties to a particular party, such as valuing unmarketable assets, inspecting or properly insuring trust-owned property, or preparing the trust's tax returns and other reports or accountings.

The Colorado Uniform Directed Trust Act

The CUDTA is Colorado's adaptation of the UDTA, which was promulgated by the Uniform Law Commission in July 2017. The CUDTA took effect on August 2, 2019 and replaced Colorado's prior directed trust statute at CRS §§ 15-16-801 et seq. As a uniform law, many of the CUDTA's defined terms mirror those in the Colorado Uniform Trust Code (CUTC), CRS §§ 15-5-101 et seq., and the Colorado Uniform Trust Decanting Act, CRS §§ 15-16-901 et seq., which promotes consistency in understanding and application. As discussed below, the CUDTA fills several proverbial holes in the prior directed trust statute and makes many rules applicable to trust directors consistent with rules that apply to trustees under the CUTC.

Establishing a Trust Director's Powers and Duties

The CUDTA does not contain any default or mandatory provisions that set forth a trust director's powers and duties; rather, the terms of a trust alone define them. Under CRS § 15-16-802(8)(a), "terms of a trust" is a term of art. It includes not only "the manifestation of the settlor's intent regarding a trust's provisions as . . . [e]xpressed in the trust instrument[,]" but also "as may be established by other evidence in a judicial proceeding." Terms of a trust may also be established by a court order, a nonjudicial settlement agreement under the CUTC, a trustee or trust director in accordance with applicable law (e.g., decanting to a second trust), or alternative dispute resolution.[14] Thus, in contrast to Colorado's prior directed trust statute, which specified that only a governing instrument (a will, trust agreement or declaration, or court order appointing a trust director) could create a trust director's powers and duties, the CUDTA provides more options for establishing them.

On establishing a trust director's powers, CRS § 15-16-806(1) provides, generally, that "the terms of a trust may grant a *power of direction* to a trust director." (Emphasis added.) Under CRS § 15-16-802(5), a power of direction is "a power over a trust granted to a person by the terms of the trust," and broadly includes "a power over the investment, management, or distribution of trust property or other matters of trust administration." The CUDTA specifies certain powers that are not powers of direction, including, but not limited to, a power of appointment; the power to remove a trustee or trust director; a power held in a nonfiduciary capacity, including a power to achieve the settlor's tax objectives under the Internal Revenue Code of 1986; and unless the terms of the trust provide otherwise, a power held by a person having custody of an animal for which care is provided by the trust, or by a remainder beneficiary of the trust, to enforce the intended use of the trust's assets for the care of such animal.[15] Further, the CUDTA provides that a power of direction cannot be exercised while a trust director is serving as a trustee.[16]

In addition to a power of direction, a trust director may exercise "any further power appropriate to the exercise or nonexercise of a power of direction granted to the director[,]"[17] unless the terms of the trust provide otherwise. Examples of such further powers include a power to

- incur reasonable costs and direct indemnification for those costs;
- make a report or accounting to a beneficiary or other interested party;
- direct a trustee to issue a certification of trust under the CUTC (CRS § 15-5-1013);
- prosecute, defend, or join an action, claim, or judicial proceeding relating to a trust; or
- employ a professional to assist or advise the trust director in the exercise or nonexercise of his or her powers.[18]

As to establishing a trust director's duties, the CUDTA applies to trust directors the same rules that apply to trustees: a trust director generally "has the same fiduciary duty and liability in the exercise or nonexercise of [a] power [of direction]" as a sole trustee or a co-trustee "in a like position and under similar circumstances."[19] Thus, the CUTC's default rules providing for the duties of loyalty, impartiality, prudent administration, and others,[20] as well as its mandatory rule establishing the duty to inform and report,[21] apply to trust directors. By expressly equating a trust director's fiduciary duty to that of a trustee, the CUDTA clarifies Colorado's prior directed trust statute, which required a trust director to act in a fiduciary capacity without delineating the extent of the fiduciary duty.

Further, unlike the prior statute, CRS § 15-16-808(1)(b) affords flexibility with respect to the extent to which a settlor may reduce or increase a trust director's fiduciary duty: the terms of a trust "may vary the director's duty or liability to the same extent the terms of the trust could vary the duty or liability of a trustee in a like position and under similar circumstances." The terms of the trust may also impose on a trust director duties or liabilities that are beyond those imposed by the CUDTA.[22] Therefore, the CUDTA provides a mandatory floor with respect to a trust director's fiduciary duty.

The Directed Trustee's Compliance

CRS § 15-16-809(1) provides that a directed trustee "shall take reasonable action to comply with a trust director's exercise or nonexercise of a power of direction . . . ." A directed trustee's duty is therefore to "take reasonable action to comply with whatever the terms of the trust require of a trustee in connection with a trust director's exercise or nonexercise of the director's power of direction. . . ."[23] Thus,

> [a] power of direction under which a trust director may give a trustee an express direction will require a trustee to comply by following the direction. A power that requires a trustee to obtain permission from a trust director before acting imposes a duty on the trustee to obtain the required permission. A power that allows a director to amend the trust imposes a duty on the trustee to take reasonable action to facilitate the amendment and then comply with its terms.[24]

As would be expected, in complying with a trust director's direction, "the trustee is not liable for the action."[25] This insulation from liability extends to the trustee's action in compliance with a further power appropriate to the exercise or nonexercise of the trust director's power of direction.[26]

The directed trustee's duty to comply, however, is limited. CRS § 15-16-809(2) provides that a trustee "must not comply with a trust director's exercise or nonexercise of a power of direction" or related "further power . . . to the extent that *by complying the trustee would engage in willful misconduct*." (Emphasis added.) This exception is consistent with Colorado's prior directed trust statute. In contrast to the UDTA, which prescribes the willful misconduct exception without elaboration, the CUDTA defines "willful misconduct" as "intentional wrongdoing and not mere negligence, gross negligence or recklessness."[27] This is the same definition of "willful misconduct" used in Colorado's prior statute. However, the CUDTA elaborates on the prior definition by providing that "'[w]rongdoing' means malicious conduct or conduct designed to defraud or seek an unconscionable advantage."[28] In other words, a directed trustee must not comply with an exercise or nonexercise of a power of direction if compliance would cause the trustee to engage in intentional malicious conduct or conduct designed to defraud or seek an unconscionable advantage.

The definitions of "willful misconduct" and "wrongdoing" are drawn from Delaware's directed trust statute, upon which the UDTA's willful misconduct standard was based.[29] These definitions clarify the extent of a trustee's potential liability when accepting an appointment and thus facilitate the use of directed trusts in Colorado.

The Uniform Law Commissioners explained their rationale for adopting the willful misconduct exception and the standard's effect on the combined fiduciary duty of the trustee and trust director:

> [B]ecause a trustee stands at the center of a trust, the trustee must bear at least some duty even if the trustee is acting under the direction of a [trust] director. . . . [T]o

facilitate the settlor's intent that the trust director rather than the directed trustee be the primary or even sole decisionmaker, it is appropriate to reduce the trustee's duty below the usual level with respect to a matter subject to a power of direction. Accordingly, . . . a beneficiary's main recourse for misconduct by the trust director is an action against the director for breach of the director's fiduciary duty to the beneficiary. The beneficiary also has recourse against the trustee, but only if the trustee's compliance with the director's exercise or nonexercise of the director's powers amounted to "willful misconduct" by the trustee. Relative to a non-directed trust, this . . . approach has the effect of increasing the total fiduciary duties owed to a beneficiary. All of the usual duties of trusteeship are preserved in the trust director, but in addition the directed trustee also has a duty to avoid willful misconduct.[30]

The willful misconduct standard is a "mandatory minimum" under the CUDTA. The terms of a trust "may not reduce a trustee's duty below the standard of willful misconduct. Terms of a trust that attempt to give a trustee no duty or to indicate that a trustee is not a fiduciary . . . are not enforceable" and would be construed as "provid[ing] for the willful misconduct standard."[31]

The directed trustee's duty to comply with the trust director's direction includes a tacit duty to determine whether the direction falls within the scope of the trust director's power of direction. If it does not, and the directed trustee acts upon an improper direction from the trust director, the trustee might not be shielded from liability. The CUDTA provides a mechanism for achieving clarity in instances of uncertainty about the scope of powers by allowing a directed trustee who has "reasonable doubt" about his or her duty to comply to petition the court for instructions.[32] Thus, for example, if a trust director with a power of direction over investment matters directs the directed trustee to export all of the trust's assets to a bank in the Cayman Islands, the directed trustee could petition the court for instruction as to whether the trust director's power to direct trust investments includes expatriating the trust's assets.

Directed Trustee's Liability for a Trust Director's Independent Action or Inaction

Colorado's prior directed trust statute expressly provided that a directed trustee had no liability for any action or inaction of a trust director. In contrast, the CUDTA is silent on the matter; it addresses only a directed trustee's liability for complying with a trust director's direction. This is consistent with CUDTA's underlying premise, which presumes that a trust director does not act independently, but only through a directed trustee who acts in compliance with the trust director's direction. However, the Uniform Law Commissioners' comments to the UDTA state that the directed trustee's duty to act reasonably in complying with the terms of a power of direction "does not . . . impose a duty to ensure that the substance of a direction is reasonable."[33] "In other words, subject to the willful misconduct rule[,] . . . a trustee is liable only for its own breach of trust in executing a direction, and not for the director's breach of trust in giving the direction."[34]

Duty to Share Information Among Trust Directors and Trustees

Under the CUDTA, trustees and trust directors bear reciprocal duties with respect to sharing information with each other. CRS § 15-16-810(1) provides that a trustee must share information with a trust director to the extent that it is "reasonably related both to . . . [t]he powers or duties of the trustee[] and . . . [t]he powers or duties of the director." Similarly, under CRS § 15-16-810(2), a trust director must share information with a trustee or another trust director to the extent that it is "reasonably related both to . . . [t]he powers or duties of the director and . . . [t]he powers or duties of the trustee or other director." The Uniform Law Commissioners explain the rationale for structuring the UDTA's information-sharing rules as follows:

> The information must be reasonably related to the powers or duties of the person making the disclosure, because otherwise that person cannot be expected to possess the information. The information must also be reasonably related to the powers or duties of the person receiving the disclosure, because otherwise that person would not need the information.[35]

Thus, directed trustees and trust directors have reciprocal duties with respect to information sharing among themselves. This represents an improvement over prior law, which obligated the directed trustee to share information unrelated to his or her own responsibilities and resulted in potential liability for not sharing information that the directed trustee should not have been expected to possess.

The CUDTA contains a provision, CRS § 15-16-810(5), that is not in the uniform law and requires a trustee to provide a copy of the terms of the trust to a trust director. The rationale for this provision is to minimize disagreements between a directed trustee and trust director about what is reasonably related to the trust director's powers or duties by providing all trustees and trust directors access to the terms of the trust.

Trust Director's Duty to Communicate with Beneficiaries

Unlike Colorado's prior directed trust statute, the CUDTA does not contain specific provisions regarding a trust director's duty to provide information to beneficiaries. However, because the Act provides that a trust director "has the same fiduciary duty and liability in the exercise or nonexercise of [a] power [of direction]" as a trustee "in a like position and under similar circumstances[,]"[36] the trustee's statutory duty to provide information to beneficiaries under CRS § 15-5-813 applies to trust directors to the same extent as it applies to trustees.

No Duty to Monitor

The CUDTA provides that directed trustees and trust directors have no duty to monitor each other.[37] This is a default rule, so it can be overridden in the terms of the trust. The rule is consistent with the Act's general exculpation of a directed trustee, in the absence of willful misconduct, for complying with a trust director's direction regarding a matter subject to the trust director's power of direction.[38] It is also consistent with the scope of the trust director's fiduciary duty and liability, which relates only to the exercise or nonexercise of his or her power of direction or any related further power.[39] This is an improvement over prior law, which provided that a directed trustee had no duty to monitor a trust director, but was silent as to whether a trust director had a duty to monitor a directed trustee or other trust director.

Like the UDTA, the CUDTA contains an apparent catch-22 relating to a directed trustee's duty to monitor. A directed trustee must not comply with a trust director's "exercise or nonexercise of a power of direction" to the extent that doing so would constitute willful misconduct by the trustee. But how a directed trustee could know of a trust director's nonexercise of a power of direction without monitoring the director is unclear, absent actual knowledge of or information about the trust director's affirmative decision not to exercise his or her power. Presumably, this knowledge could likely be obtained only through the trust director's express communication to the directed trustee, which the trust director is likely under no duty to make, or through the trustee's ongoing monitoring of the trust director's conduct. Thus, the CUDTA leaves open whether a trustee has a duty to take some action when faced with a trust director's nonexercise of a power, and the nature of that duty, if it exists. These questions likely cannot be answered until these CUDTA provisions are interpreted by a court.[40]

No Duty to Warn

Unless the terms of the trust specify otherwise, under CRS § 15-16-811(1)(a)(II) a directed trustee has no duty to "[i]nform or give advice to a settlor, beneficiary, trustee, or trust director concerning an instance in which the trustee might have acted differently than the director." A trust director is similarly relieved of such a duty with respect to situations in which he or she might have acted differently than the directed trustee or another trust director.[41] This is a default rule that can be altered in the terms of the trust. The rule fills a gap in Colorado's prior directed trust statute, which provided that a trust director had no duty to communicate with or warn any beneficiary or third party concerning actions taken by another trust director or directed trustee, but was silent regarding a similar duty on the part of the directed trustee.

The use of the past tense in the CUDTA's duty-to-warn language indicates that the exemption from the duty to inform or advise may be retroactive.[42] Thus, a directed trustee or trust director may have a duty to inform or advise regarding actions not yet taken, of which the trustee or director has knowledge and against which some preventative measures might be effective. The Uniform Law Commissioners' comments to the UDTA are silent on the issue, so a definitive answer will have to be provided by the courts.

> "Thus, a directed trustee or trust director may have a duty to inform or advise regarding actions not yet taken, of which the trustee or director has knowledge and against which some preventative measures might be effective."

Even though directed trustees and trust directors have no statutory duty to warn, if they choose to do so, would they thereby assume an ongoing duty to warn? The CUDTA says no: CRS § 15-16-811(1)(b) provides that if a directed trustee gives information or advice to a beneficiary, settlor, another trustee, or a trust director regarding an instance in which the trustee might have acted differently than a trust director, the trustee does not assume a duty to do so. The Uniform Law Commissioners' comments to the UDTA explain: "The purpose of these provisions is to ensure that if a directed trustee chooses for some reason to monitor, inform, or give advice, the trustee does not assume a continuing obligation to do so or concede a prior duty to have done so."[43] A trust director is similarly relieved of such a duty with respect to situations in which he or she might have acted differently than the directed trustee or another trust director under CRS § 15-16-811(2)(b).

Office of Trust Director

The CUDTA expressly applies to trust directors the same default rules that apply to a trustee under the CUTC regarding acceptance of appointment, giving of bond to secure performance, reasonable compensation, resignation, removal, and vacancy of the office and appointment of a successor.[44] It also provides that by accepting an appointment as a trust director, the trust director "submits personally to jurisdiction of the courts in this state regarding any matter related to a power or duty of the director,"[45] and allows a trust director to petition the court for instructions under CRS § 15-5-201(3).[46]

Limitation of Actions against a Trust Director

With the adoption of the CUDTA, the three-year statute of limitations that formerly applied to trust directors, CRS § 13-80-101(1)(f), no longer does. The Act instead applies to trust directors existing state law regarding limitation of actions against trustees: "An action against a trust director for breach of trust must be commenced within the same limitations period as an action against a trustee for a similar breach of trust as prescribed by section 15-5-1005."[47] Thus, a beneficiary must generally commence a judicial proceeding for breach of trust against a trust director within three years after the first to occur of the removal or resignation of the trust director, the termination of the beneficiary's interest in the trust, or the termination of the trust,[48] or against the trust director's estate within one year after his or her death.[49]

However, under CRS § 15-5-1005(1) a trust director may avail himself or herself of the reduced limitations period available to trustees under the CUTC:

> A beneficiary may not commence a proceeding against a [trust director] for breach of trust more than one year after the date that the beneficiary . . . was sent a report that adequately disclosed the existence of a potential claim for breach of trust and informed the beneficiary of the time allowed for commencing a proceeding.

The CUDTA confirms that a "report or accounting has the same effect on the limitation period for an action against the director that the report or accounting would have if the director were a trustee as prescribed by section 15-5-1005."[50] A report would be deemed to adequately disclose the existence of a potential claim if it "provides sufficient information so that the beneficiary . . . knows of the potential claim or should have inquired into its existence."[51] This reduced limitations period encourages trust directors to regularly account to beneficiaries in writing and rewards them for doing so by not allowing beneficiaries to sit on their rights for a potentially lengthy period of time.

Drafting and Practical Considerations

Directed trusts present challenges that estate planners must consider when crafting estate plans and drafting trust instruments.

Selecting Trustees and Trust Directors

A directed trustee and trust director must interact with each other throughout a trust's administration. The law requires the sharing of certain information between a directed trustee and trust director, and among trust directors. Selecting persons for these roles who can communicate effectively and work productively together is critical for the success of a directed trust arrangement.

At the outset of administration, the directed trustee and trust director should meet to identify the areas in which they will need to work together and discuss the logistics of how they will do so. The decisions made should be memorialized in a written memorandum of understanding that the directed trustee and trust director can refer to throughout the trust's administration. The directed trustee and trust director can agree to revise the memorandum from time to time as the administrative demands of the trust may require. The trust instrument can be drafted to require this process.

Defining Roles and Responsibilities

Because fiduciary duties are divided among one or more directed trustees and trust directors in a directed trust arrangement, it is essential to think through and clearly define in the trust instrument the functions allocated to the directed trustee(s) and trust director(s). Each situation is different. A common directed trust scenario involves appointment of a professional investment advisor as a trust director responsible for investing trust assets. The following questions should be addressed in this scenario.

What will be the scope of the trust director's power of direction? It is unlikely that a professional investment advisor will accept responsibility for investing trust assets in anything other than securities and bank deposits. Thus, the power to invest in other asset types should be given to the directed trustee or another trust director, which would allow him or her, for example, to purchase a trust-owned residence for a beneficiary. The trust instrument should make this division of the investment power clear.

Will the trust director act with discretion? This is not so much a drafting issue as a question that must be asked of a professional investment advisor before he or she is nominated to serve as a trust director. "Discretion" here means that the advisor will purchase and sell securities in the exercise of his or her own discretion, without first contacting a client for consent. If the advisor will not act with discretion, he or she should not be nominated. Providing consent to securities trades would constitute an act outside of the directed trustee's defined powers.

How will directions be given and received? The CUDTA does not provide a mechanism for how directions are to be given or received. To avoid confusion, the trust instrument should specify a process for this, and indicate that all directions should be in writing, so the trust director knows that the directed trustee has received the direction.

Who will have custody of the assets that the trust director manages? Many professional investment advisors either insist on or have a strong preference for having custody of the assets they will manage. However, professional directed trustees typically wish to retain custody of all trust assets. In fact, the CUDTA and many other directed trust statutes contemplate that the directed trustee will have custody. One solution to this dilemma is for the trust director to direct the directed trustee to invest the trust's assets in a single-member limited liability company (LLC) owned by the trust and managed by the trust director. The directed trustee would then have custody of the LLC interest, while the trust director could open an account titled to the LLC (with a qualified custodian of his or her choosing) in which he or she would manage the LLC's assets. Alternatively, the trust instrument could be drafted to allow the trust director to manage the trust's assets from one or more accounts with a qualified custodian chosen by the trust director, in the exercise of a further power appropriate to the exercise of the trust director's power of direction. In either case, the trust instrument should specify that only the directed trustee may make distributions, and that the trust director is prohibited from doing so.

If the trust director will have custody of trust assets, ideally the asset custodian that he or she uses should be capable of properly allocating interest, dividends, and capital gains to principal and/or income in accordance with the Uniform Principal and Income Act. The trust instrument should specify whether the trust director or directed trustee is responsible for making such allocations, following inquiry into the trust director's capability.

Who is responsible for valuing the assets? Typically, if a professional investment manager serves as the trust director responsible for trust investments, he or she should be responsible for valuing only those assets under his or her management.

How will the directed trustee be ensured prompt access to money needed to meet the distribution demands and expenses of the trust? The directed trustee should be empowered under the terms of the trust to direct the trust director to raise cash, should the directed trustee require funds to make distributions or pay expenses of the trust, and the trust director should be required to comply. If the directed trustee can maintain a separate pool of funds from which to make distributions and meet expenses, how and where those funds are invested (and who makes those decisions) should be clearly defined.

Shelton v. Tamposi[52] highlights the importance of clarifying in the trust instrument whose power has priority when investment and distribution decisions are placed in different hands. In *Shelton*, the directed trustee was in charge of distributions and the trust directors were responsible for investing and managing trust assets. The trust directors had sole authority to direct the retention or sale of all assets and to direct the purchase of property with cash principal. The directed trustee claimed that she could require the trust directors to sell illiquid investments to make funds available for distributions. Affirming the lower court, the New Hampshire Supreme Court disagreed and held that the directed trustee's authority is subordinate to that of the trust directors. This holding may be counterintuitive, and thus emphasizes the need to address the issue in the trust instrument.

Who will prepare an investment policy statement? The trust instrument should require the trust director to prepare and give to the directed trustee a written investment policy statement. Alternatively, if the trust director is a professional investment advisor and will not unilaterally prepare an investment policy statement without the agreement of a client, the trust instrument should require that the trust director and the directed trustee (or other trust director) jointly prepare it. This statement should describe the trust's overall investment goals; the strategic asset allocation for the trust (i.e., the percentages to be allocated to equities, fixed-income securities, cash, and other asset classes, and appropriate ranges for each); the specific types of investment vehicles that the trust director may use; the maximum percentage of the trust's assets (or of the trust's equity or fixed-income portfolios) that may be invested in any individual security and a single industry at the time of purchase; the maximum percentage of the trust's assets that may be invested in illiquid or unmarketable investments; if applicable, whether or to what extent the trust director's proprietary investment products may be used; and any additional considerations from an investment perspective. The goal here is for the directed trustee to know what to expect from the trust director and to determine whether the trust director's proposed action is consistent with his or her power of direction.

Trust Director Succession

If a trust director is no longer able or willing to serve, a successor trust director must be ready to step in. The trust instrument should always define a clear process by which a successor trust director will be selected so there is never a default in the trust director's role.

One option is for the directed trustee to assume functions previously performed by a trust director. If this is desirable, the trust instrument should include a provision allowing the directed trustee to consent within a reasonable time before doing so, because taking on those functions may substantially increase the directed trustee's responsibilities. Depending on the directed trustee's skills and expertise and the nature of the trust director's functions, the directed trustee may not be equipped for or wish to assume that responsibility. If the directed trustee does not consent within a reasonable time or affirmatively declines to assume the trust director's responsibilities, a new trust director should be appointed under a process defined in the trust instrument.

Duty to Monitor or Warn

The CUDTA's default rules that directed trustees and trust directors have no duty to monitor each other or warn beneficiaries or other parties regarding each other's prior actions may be altered in the terms of the trust. But practitioners should seriously consider the wisdom of altering these rules. As soon as a directed trustee or trust director is given a duty to monitor or warn, the directed trust begins to operate more like a delegation (see discussion of delegated trusts above). This could lead to unintended consequences, including fiduciaries' unwillingness to serve, increased costs, and even acrimony among fiduciaries, which could interfere with an efficient and orderly administration.

Fiduciary Fees

Generally, the overall fees chargeable to a trust will increase in accordance with the number of fiduciaries involved. In a directed trust where a professional directed trustee has been appointed but a professional investment advisor serves as trust director responsible for investing trust assets, two separate fiduciaries will have to be paid. This is not to say that the directed trust arrangement is undesirable, but the fiduciary fees that the trust will shoulder over time should be considered to minimize erosion of the funds available for the beneficiaries.

Converting a Non-Directed Trust to a Directed Trust

Under the CUTC, converting an existing non-directed trust to a directed trust can be a straightforward and inexpensive matter, provided all parties with material interests agree. The CUTC provides for nonjudicial settlement agreements, under which parties may bind themselves regarding "any matter involving a trust."[53] These agreements do not need to be supported by consideration.[54] Required parties to a nonjudicial settlement agreement include "persons whose interests in the trust would be materially affected by its provisions . . .,"[55] but other persons may also be parties. A nonjudicial settlement agreement is valid only to the extent that "it does not violate a material purpose of the trust" and "includes terms and conditions that could be properly approved by the court . . . ."[56] Therefore, if the persons whose interests would be materially affected agree, and their agreement does not violate a material purpose of the trust and could be approved by the court, an existing non-directed trust can be converted to a directed trust without court involvement. Such an agreement should address the drafting and practical considerations discussed above.

If the "cover" of a court order is desired, a party to a nonjudicial settlement agreement could seek court approval via hearing without appearance, which should minimize the cost of court involvement.[57]

If a nonjudicial settlement agreement cannot be achieved, conversion to a directed trust could be pursued through judicial modification under the CUTC (CRS § 15-5-411), or through decanting under the Colorado Uniform Trust Decanting Act, CRS §§ 15-16-901 et seq.

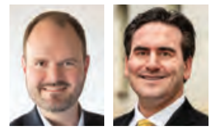
Advising Fiduciaries

When a non-directed trust experiences a loss as a result of negligence, recklessness, or willful misconduct, the trustee is ultimately responsible. Identifying the culpable and ultimately responsible party in a directed trust context may not always be so clear, as the CUDTA allocates the duties and liabilities among the various fiduciaries. Therefore, each directed trustee and trust director should expect to be named in any lawsuit alleging breach of trust. The following actions will help identify the fiduciary who is culpable in a breach of trust action:

- identify the aspect of trust administration from which the loss occurred;
- identify the party, under the terms of the trust, who had authority over the aspect of trust administration from which the loss occurred; and
- determine whether the party identified was, under the terms of the trust and Colorado law, solely responsible for the loss or whether another fiduciary should properly share in the loss.[58]

Conclusion

Directed trusts allow trust settlors to involve all fiduciaries who can best achieve their desired goals in the administration of their trusts. The CUDTA provides an efficient framework for establishing and administering directed trusts that integrates seamlessly into Colorado's existing body of trust law. To ensure successful trust administration, practitioners are advised to draft trust instruments that clearly address the powers and duties of trust directors and directed trustees within the context of the specific trust they will administer. CL



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NOTES

1. *See, e.g.*, CRS § 15-1-804(2)(x)(I), which provides that a trustee may employ attorneys or other directors to advise or assist the trustee in performing his or her duties, or to do any ministerial act required to be performed by the trustee.
2. *See, e.g.*, CRS § 15-1.1-109(a), which provides that in delegating investment and management functions, a trustee must exercise reasonable care, skill, and caution in selecting an agent, establishing the scope and terms of the delegation, and monitoring the agent's performance; and CRS § 15-1-804(1), which provides that a fiduciary has a duty to act reasonably and equitably with due regard for his or her responsibilities toward the interests of beneficiaries and creditors, the estate or trust involved, and the purposes thereof.
3. *Restatement (Second) of Trusts* § 171 cmt. d (American Law Institute 1959).
4. *In re Will of Hartzell*, 192 N.E.2d 697, 707–10 (Ill.App. 1963).
5. *Id.* at 710.
6. *Id.* at 706.
7. *Restatement (Third) of Trusts* § 80 (American Law Institute 2007).
8. *Id.*
9. Only California, Louisiana, and New York have not enacted some form of directed trust statute.
10. *Duemler v. Wilmington Trust Co.*, 2004 Del. Ch. LEXIS 206 (2004).
11. *Id.* at *2.
12. *Rollins v. Branch Banking & Trust Co. of Va.*, 56 Va. Cir. 147 (2001).
13. *Id.* At *3
14. CRS § 15-16-802(8)(b).
15. CRS § 15-16-805(2).
16. CRS § 15-16-802(5).
17. CRS § 15-16-806(2)(a).
18. *See* UDTA § 6 cmt. (2019).
19. CRS § 15-16-808(1)(a).
20. *See* CRS § 15-5-801, -812.
21. *See* CRS § 15-5-813.
22. CRS § 15-16-808(3).
23. UDTA § 9 cmt.
24. *Id.*
25. CRS § 15-16-809(1).
26. *Id.*
27. CRS § 15-16-802(11).
28. CRS § 15-16-802(12).
29. *See* 12 Del. C. § 3301(g), (h)(5).
30. UDTA § 9 cmt.
31. *Id.*
32. *See* CRS § 15-16-809(4).
33. UDTA § 9 cmt.
34. *Id.*
35. UDTA § 10 cmt.
36. CRS § 15-16-808(1)(a).
37. CRS § 15-5-811(1)(a)(I), (2)(a)(I).
38. *See* CRS § 15-5-809(1), (2).
39. *See* CRS § 15-16-808(1).
40. Given the high bar to trustee liability inherent in the willful misconduct exception, this issue may be academic, but it theoretically exists.
41. *See* CRS § 15-16-811(2)(a)(II).
42. Under principles of statutory construction, a court "is bound to apply the plain language of a statute to accomplish the intent of the General Assembly. If the language is clear and unambiguous, the court will not look to rules of construction or to legislative history; it will simply apply the language." Colorado General Assembly, https://leg.colorado.gov/agencies/office-legislative-legal-services/commonly-applied-rules-statutory-construction.
43. UDTA § 11 cmt.
44. CRS § 15-16-816.
45. CRS § 15-16-815(1).
46. CRS § 15-16-816(1)(g).
47. CRS § 15-16-813(1).
48. *See* CRS §§ 15-5-1005(3) and 15-16-813(1).
49. *See* CRS §§ 15-12-803(1)(a)(III) and 15-15-103(8).
50. CRS § 15-16-813(2).
51. CRS § 15-5-1005(2).
52. *Shelton v. Tamposi*, 62 A.3d 741 (N.H. 2013).
53. CRS § 15-5-111(1).
54. *Id.*
55. CRS § 15-5-111(2).
56. CRS § 15-5-111(3).
57. *See* CRS § 15-5-111(5); Colo. R. Prob. P. 24.
58. Directed trustees remain bound by fiduciary duties in complying with a trust director's directions. Thus, for example, where a trust instrument simply grants a trust director the power "to direct the trustee to sell trust assets" and the trust director instructs the directed trustee to sell an asset, the directed trustee must sell it within the confines of the directed trustee's normal fiduciary duties, such as those with respect to the sale price and other terms of the sale. *Restatement (Third) of Trusts*, *supra* note 7 at § 75 cmt. b.

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