

## **Trustee Liability in a Multi-Participant Trust**

*By Rose Wilson*

In our firm's most recent white paper, Brad Kitlowski covered the topic of exculpatory clauses in trust agreements and whether these clauses are effective to protect trustees against claims of breach of fiduciary duty. In this white paper, I will examine whether it is possible to protect trustees against claims of breach of fiduciary duty by designating other persons to perform certain fiduciary functions.

The practice of dividing a trustee's traditional responsibilities among different persons has become increasingly popular. For example, trust agreements are increasingly incorporating "trust protector" provisions in which a person called the trust protector is given certain powers over the trust that might otherwise be held by the trustee. A trust protector's powers might include the power to terminate the trust, the power to modify the trust's distribution provisions, the power to add or remove trust beneficiaries, or the power to approve the trust's investment portfolio. Trust agreements that allocate powers among multiple persons are sometimes referred to as multi-participant trusts. Some commonly used terms for the non-trustee persons in multi-participant trusts include "trust protector", "trust adviser", "investment advisor", or "administrative trustee", to name a few.

Many times, the intent behind the use of multi-participant trusts is to shift liability away from the trustee to another person, or to eliminate liability associated with the function altogether. A trustee's fiduciary duties to the trust beneficiaries are determined by the applicable trust instrument and governing law. Under common law, when there are multiple persons performing fiduciary functions on behalf of the trust, those persons are generally required to prevent each other from breaching their fiduciary duties, and may be held liable for failing to do so. However, many states have adopted statutes that modify common law requirements with respect to multi-participant trusts, and these statutory laws can vary widely from state to state.

Although some states have not modified the common law requirements for multi-participant trusts, most states have adopted statutes that specifically allow trustees to delegate trust administration functions to others. However, the delegating trustee generally has a continuing fiduciary duty to oversee the performance of the delegated function and may still be held liable if the function is not handled properly or if the trustee was negligent in hiring the delegatee. Therefore, these statutory provisions do little to protect a trustee from liability.

Some states have adopted fiduciary bifurcation provisions, or so-called "directed trust" statutes, that allow the trust agreement to split certain fiduciary responsibilities among different people, usually by designating one person to control the investment decisions on behalf of the trust and another person, usually called the "directed trustee", to handle all other fiduciary functions. However, these statutes vary in the amount of protection provided to the directed trustee.

In many states with directed trust statutes, the statutory language follows a portion or all of § 185 of the Second Restatement of Trusts or § 808(b) of the Uniform Trust Code, both of which require the directed trustee to monitor the actions of the other person. Under § 185 of the Second Restatement of Trusts, the directed trustee generally has a duty to prevent a violation of the trust terms or a breach of fiduciary duty. Under § 808(b) of the Uniform Trust Code, the directed trustee generally has a duty to prevent the other person from exercising a power in a manner that is manifestly contrary to the terms of the trust or if there will be a serious breach of fiduciary duty that is owed to the trust beneficiaries. Only a few states have adopted laws that provide the directed trustee has no duty to monitor the conduct of the other person, and even in these states, the statutory protection may be subject to attack under public policy arguments or if the trust agreement is not properly drafted.

There are very few cases involving the liability protections afforded to trustees through the use of directed trust statutes, so trustees of multi-participant trusts should exercise caution in the administration of such trusts even if state laws are favorable to the trustee. Notwithstanding the protection that may be available to the trustee through applicable statutory law, our advice to trustees is to always maintain best practices in the administration of a trust, such as holding regular meetings with the persons involved in the trust administration, keeping detailed documentation of all decisions concerning the trust, and seeking the advice of legal counsel when issues of concern arise during the administration of the trust.