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"To Be or Not to Be (A Fiduciary)" Is Not the Question
Think Deeper about Protectors and Their Powers

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The use of trust advisors and protectors in the domestic trusts & estates context has increased dramatically over the past couple of decades. Originally found in offshore asset protection trusts, the concept of granting discrete powers to a non-trustee power holder has introduced a great deal of flexibility in trust design and administration.

The popularity of trust advisors and protectors is reflected in the growing body of statutory recognition, now extending to several states with directed trust statutes on the books. Statutory recognition is sure to grow in the years to come as states consider adopting provisions from the Uniform Trust Code. Section 808(b) of the UTC contemplates the role of the trust protector or trust advisor as authorized third parties who may be empowered by a trust settlor to hold and exercise certain powers.

Though statutory law is growing, there is scant case law to guide practitioners through some of the more challenging issues concerning trust advisors and protectors. Moreover, scholars disagree – sometimes stringently – on the propriety of using trust protectors beyond the offshore asset protection trust context.

As author Alexander Bove illustrated clearly in LISI #2432, *To Be or Not to Be – A Fiduciary, That Is* (June 30, 2016), the rise in the use (or abuse?) of trust protectors in modern trust design and administration has given rise to the hotly-contested issue of whether or not the trust protector is a fiduciary. Mr. Bove makes some essential and valid points, but I believe the issue is more complex and cannot be so neatly defined; a deeper analysis is required.

I believe that a blanket assertion that a protector is not a fiduciary – as well as an assertion that a protector must always be a fiduciary – looks at the role too simplistically. The protector's role may be too complex to be defined as "always" or

"never." We must, as Mr. Bove indicates, consider the basic role of the protector, but we might also consider that the "basic role" may be different in one strategy than it is in another.

Beyond the basic role, we should also consider the nature of the underlying powers granted to the trust protector and the relationship between the individual occupying the protector's role to the other parties in the trust before we decide whether the protector is or should be treated as a fiduciary.

The protector's "basic role?"

This itself is an issue of some controversy. Why does the trust protector exist in the first place? Does the protector serve the interests of the beneficiaries to ensure efficient and responsive administration by the trustee? Does the protector serve to provide flexibility in an irrevocable plan to adjust the plan as laws change, as the beneficiaries' lives change, or as new opportunities emerge that can better carry out the settlor's intent? Does the protector serve to remove important trust administration decisions from the jurisdiction of a clogged and often uninformed judiciary?

In some cases, the answer is, "All of the above." There are surely many other wholly legitimate uses for the trust protector, and the discrete powers granted to the protector in furtherance of its role begin to fill in the *nature* of the protector's role.

Get clear on intent

The protector's role in a trust must begin with a clear statement of intent. The settlor, through the drafting attorney's counsel and tailoring, should lay the foundation of intent upon which the protector's powers are built.

For example, a provision might be included to the effect of:

> *The Trust Protector's purpose is to direct the Trustee in matters concerning the trust, and to assist in achieving our objectives as expressed by the other provisions of our estate plan if needed.*[1]

The extent of any duty this language imposes on a protector should be further defined by the governing instrument and when possible, colored in by applicable state law. As Mr. Bove stated, some powers commonly granted to a protector "…are or can be [interpreted as] clearly fiduciary…" in nature.[2]

Certainly some powers held by a protector are at least quasi-fiduciary in nature. Is it reasonable to assume that those powers which, if held by a trustee would subject the

trustee to the level of scrutiny extended to a fiduciary, but when held by someone else, they would not?

But what about those powers that are not quasi-fiduciary? Are there some powers that a protector might hold that a trustee cannot effectively hold? Are there some powers that are desirable to include for smooth administration or to capitalize on changed circumstances, but that simply cannot be exercised in a fiduciary manner?

U.S. law and trust advisors and protectors

At least 22 states statutorily recognize the existence of trust advisors or protectors. Of those, 17 require that the powers the advisor or protector possesses be specifically enumerated within the governing will or trust instrument. Some of the states' laws are fairly comprehensive, but many leave wide gaps and little clarity about the scope and limits of the protector's role, the nature of permissible powers, and how the protector interacts with other trust parties.

Many states swept in trust protector provisions as they adopted the Uniform Trust Code, as §808 of the UTC contemplates protectors as third parties holding powers over the trust. The text of §808 does not contain any specific reference to trust protectors in the substantive provision of the statute. We must thus consider the comments to the draft §808 that provide in pertinent part:

> *…Subsections (b)-(d) ratify the use of trust protectors and advisers. Subsections (b) and (d) are based in part on Restatement (Second) of Trusts § 185 (1959). Subsection (c) is similar to Restatement (Third) of Trusts § 64(2) (Tentative Draft No. 3, approved 2001). "Advisers" have long been used for certain trustee functions, such as the power to direct investments or manage a closely-held business. "Trust protector," a term largely associated with offshore trust practice, is more recent and usually connotes the grant of greater powers, sometimes including the power to amend or terminate the trust. Subsection (c) ratifies the recent trend to grant third persons such broader powers.*

The comments also provide that the provisions set forth under §808 should be alterable by the settlor within the trust agreement. So while the provisions of the model act state that the holder of a power to direct is "presumptively a fiduciary" and that the trustee "shall act in accordance" with an exercise of a protector's power, there is nothing in the model act that would prevent a settlor from closely tailoring the roles and powers of those power holders.

Common powers granted to trust protectors

When it comes to defining trust protector powers, creativity reigns. Surely, the purpose of the trust protector is to provide flexibility for a trust that is likely to last for many years beyond the death of the settlor. After all, the protector can act to accommodate the inevitable changes that will occur to state trust law, state and federal tax laws, and the unique circumstances the beneficiaries will face while the trust is under administration.

It is likely impossible to collect and classify the whole world of powers that may be given to protectors. Even more confounding is the disparity with which the states determine whether the protector is or is not a fiduciary. The inconsistencies among the states have fueled much scholarly debate about whether the protector is *always* a fiduciary, *never* a fiduciary, or somewhere in between.

As we unpack this confusion it is possible to consider a broader framework into which those powers should fall, and within which we can determine whether a power should be held in a fiduciary or nonfiduciary capacity.

Inconsistent state law weaves a Joseph's Cloak of confusion

When we look to the body of state law concerning trust protector powers we find little consensus about whether the protector is or is not a fiduciary, and whether or not the settlor can modify that classification in the governing instrument. For attorneys practicing in states that have protector statutes on the books, it is essential to be familiar with the scope and limits of prevailing protector laws and the degree to which the powers and duties can be shaped by drafting.[3]

For example, several states specify that the protector (or in some cases, the trust "advisor") is a fiduciary by default, but that the governing instrument can change that standard. As mentioned above, this is also the default provision endorsed in the comments to §808 of the Uniform Trust Code.

There is, however, a handful of states that have started thinking more deeply on the nature of protector powers and have begun tailoring the protector's fiduciary or nonfiduciary capacity to the nature of the power granted. These states provide that the protector is a fiduciary when he or she holds "trustee-like" powers. It is here that we begin to find a useful framework within which we can organize protectors' powers.

For example:

- In Idaho, the trust *advisor* is a fiduciary *when exercising investment powers* unless the governing instrument provides otherwise.[4]
- In Wisconsin, the protector is a fiduciary when exercising investment *or distribution* powers, when construing the trust at the request of the trustee, or when resolving disputes among beneficiaries unless the governing instrument specifies to the contrary. In all other circumstances the protector holds power in a nonfiduciary capacity (unless again, the document specifies otherwise).[5]
- South Dakota takes a similar approach by stating that the trust advisor is a fiduciary when given authority to direct, consent to, or disapprove a fiduciary's investment decisions unless the document states otherwise.[6] The powers of the trust protector may be exercised or not exercised in the protector's "sole and absolute discretion", suggesting that there is no fiduciary duty that attaches to the protector. Presumably the document could specify to the contrary.[7]

U.S. case law and the role of the trust advisor & protector

While it is true that we generally inherited the use of trust advisors and protectors from the world of offshore asset protection trust planning, it would be inaccurate to say that domestic case law is silent on the issue. Several cases[8] under U.S. law that referenced the use of a non-trustee "trust advisor", examined the advisor's role and determined the nature with which the advisor held its power. All of those early cases found that the trust advisor is a fiduciary, *because in each instance the advisor held powers that impacted the manner in which the trustee exercised its fiduciary duty over the trust.*

A new paradigm: consider the nature of the power

Drawing from the handful of states that have begun to distinguish between types of powers – a paradigm first set forth under *Crocker*[9] – we can begin to further build a framework within which we can organize protectors' powers, and identify the nature with which they hold those powers. I believe we can establish at least two clear and distinct tranches: trustee-like, or "quasi-fiduciary" powers, and court-like, or "quasi-judicial" powers. There are also some commonly-granted powers that may not neatly fit into this framework, which likely require additional thought and careful drafting.

Trustee-like powers

Some powers just look inherently like the kind of powers that a trustee might hold, which impact the regular operations and management of the trust. In fact, if the trust did not provide for a trust advisor or protector, these are the kinds of powers that might otherwise be held by a trustee. These may include the power to:

- Advise or manage the exercise of discretionary distribution authority by a corporate trustee;
- Advise the trustee concerning the timing and nature of distributions from the trust;
- Advise the trustee in making allocations of capital gains to income, or veto those decisions if made by the trustee;
- Advise the trustee in selling assets, or vetoing sales if necessary;
- Direct or guide the trustee concerning investment decisions;
- Supervise other actions of the trustee;
- Break a deadlock among trustees;
- Manage a trust-owned business; and
- Vote stock shares owned by the trust.

Powers like these listed above tend to look and feel like trustee powers. They're "quasi-fiduciary" by their very nature. Each of these powers could certainly be held by a trustee, and the trustee is always held to a fiduciary's standard of care. It would indeed defy logic to argue that these powers should not be subject to that same standard when held and exercisable by another party. Thus, when the trust protector holds trustee-like powers, they should generally be held to a fiduciary standard.

Court-like powers

Another collection of powers does not look like trustee powers at all; rather, they are the kinds of powers a court might exert over the trust. These powers are often granted for the specific purpose of keeping trust administration out of the court, allowing a knowledgeable and independent third party to exercise powers that would otherwise be conferred to the court. These may include the power to:

- Resolve disputes among the beneficiaries concerning the trust;
- Modify trust provisions through an amendment power;
- Grant, revoke, or modify powers of appointment (as an extension of the amendment power);
- Add or delete beneficiaries;
- Change the nature of a beneficial interest or change a distribution standard, such as from an ascertainable "HEMS" standard to a purely discretionary distribution power;
- Prevent a beneficiary from assigning his or her interest in the trust;
- Construe trust terms to resolve ambiguity;
- Terminate the trust;
- Remove or replace the trustee;

- Approve the trustee's compensation; and
- Approve trustee accountings.

These kinds of powers do not directly impact the day-to-day administration of the trust and would generally be exercised only in very limited circumstances. In fact, these are the kinds of issues that historically get referred to the court for resolution. One could well argue that these powers could *never* be exercised in a fiduciary capacity because the nature of the power itself would require the protector to favor one beneficiary over the other, or be seen as acting preferentially against the beneficiaries in favor of the trustee.

It stands to reason that a third party holding these powers should not be held to a fiduciary standard, but would be treated as an independent arbiter to carry out the probable intent as expressed in the document – just as a court might do under the doctrine of equitable deviation.

Other special powers

There is a third category of powers that may not neatly fit into the "trustee-like" or "court-like" distinction. These are powers that may be held by a trustee (fiduciary) or exercised by a court (nonfiduciary), and so the trust instrument should specify accordingly. These include the power to:

- Designate the succession of trustees (for instance, where the trust is silent);
- Change the governing law of the trust;
- Change the trust situs; and
- Provide nonbinding guidance or advice to the trustee.

Powers like these do not neatly fit into our "quasi-fiduciary-or-quasi-judicial" paradigm. In the case of providing *nonbinding* guidance to a trustee, there should surely be no liability extended to the protector; the trustee is free to do what she will with the protector's advice, and the trustee should thus remain fully liable for the impact of her decisions. Other powers, like changing situs of the trust or changing the governing law to apply to trust administration may have far-reaching implications on the beneficiaries' rights and income tax treatment. Those powers are sometimes granted to an independent trustee, and they may certainly be exercised by a court. To this end, these powers may be either fiduciary or nonfiduciary, but should be defined by the governing instrument.

Tailor the standard to the power

Because state law is confused at best, practitioners must consider the nature of each trust protector power, consider whether the power is quasi-fiduciary or quasi-judicial in nature, and then assign the fiduciary or nonfiduciary standard to each of those powers accordingly.

For example, administrative, trustee-like powers that most directly impact the day-to-day operations of the trust and how the trustee carries out its duties perhaps should be held to a fiduciary standard. After all, if the trust protector can *direct* investments – and if the trustee is *compelled* to follow the protector's direction – who should bear the liability associated with those decisions? Surely the trustee should be exonerated from liability if he is required to follow the protector's guidance. To not expect the protector to be bound to a fiduciary standard in directing those investments is to expose the beneficiaries to capricious investment decisions without recourse.

Other powers appear to defy the ability to be held to a fiduciary standard. For example, if a trust protector were to add a beneficiary to the trust, would not the exercise of that power dilute the interests of other beneficiaries? How could a protector ever exercise that power in a fiduciary capacity when the very exercise of that power would violate the duty of impartiality?

Similarly, if the protector must resolve disputes among beneficiaries, doing so would necessarily favor one beneficiary over another, again frustrating the very nature of the fiduciary's duties of loyalty and impartiality. When the powers are clearly delineated in the governing instrument, with careful thought and clear language determining which powers are held in a fiduciary capacity and which are not, we take away the capricious classification of "all or nothing" and look more completely at the nature of the protector's role and attendant powers.

Applying safeguards

Indeed, we practitioners cannot blithely dispense of fiduciary duty when the power held looks for all the world like the kind of power a trustee would hold. But nor do I believe that we should blithely apply a fiduciary standard when the power looks like a power that could only be exercised by a court. Such an all-or-nothing proposition neither protects the integrity of the client's plan nor addresses the important nuances of the evolving trust protector's role.

In addition to classifying and defining each power granted to the protector, we must also create mechanisms by which a protector is held accountable – by removal and replacement, at a minimum – by an independent party. One method worth considering

is whether the drafting attorney, or a successor attorney, should be able to remove and replace a protector upon investigation, after inquiry by an interested party in the trust (such as the trustee or a beneficiary).

There are other important issues to consider when using a protector, such as which powers to give in which situations, who can and should serve as protector, how the protector should be compensated, and who should hold the power to remove and replace the protector. But I believe we can apply a logical framework to the nature of the powers given to protectors, view it through the lens of applicable law, and clearly address the "fiduciary-or-not" question within our trust documents.

I heartily echo Mr. Bove's admonition against exonerating protectors from all liability in the exercise or nonexercise of the powers granted them, but I believe that we cannot simply state that the role of the protector is, by its very nature, a fiduciary position. Nor do I believe that it is some squishy, in-between role. The protector might be at one time both a fiduciary and a nonfiduciary, depending on the context in which they serve. We must look more deeply to the nature of the powers granted, and then assign the appropriate standard – fiduciary or nonfiduciary – to each power in kind.

Perhaps this notion argues in favor of having two separate powerholders: perhaps a trust protector (nonfiduciary, holding quasi-judiciary powers) and a trust advisor (fiduciary, holding quasi-fiduciary powers). That would certainly provide greater clarity, but it would also likely increase administrative challenges and expenses in managing the relationships. At a minimum, the powers granted to the powerholder must be carefully defined, with an appropriate assignment of the nature by which the power is held.

Doing so likely makes for a longer document, but it certainly provides for greater clarity. That greater clarity will likely help keep matters off the court dockets, and it creates discipline in drafting by which learned practitioners – and not overwhelmed local judges – shape the evolution of the protector's role.

[1] This is excerpted from the default intent language that merges in the Wealth Docx trust assemblies when an option to include a trust protector is selected. As with all document assembly systems, language must be carefully reviewed and adjusted to ensure it reflects the settlor's desires.

[2] Alexander A. Bove, Jr., To Be or Not To Be – A Fiduciary, That Is The Question (LISI #2432, June 30, 2016)

[3] For an excellent discussion on these issues, please see: Kathleen R. Sherby & Justin T. Flasch: The Nature and Effective Use of "Trust Advisors" and "Trust Protectors" as Third Party Decision Makers (ALI-CLE Seminar Resource, March 24, 2015)

[4] Idaho Code Ann. §15-7-501(4). Although Idaho distinguishes between advisors and protectors, its Code is silent as to the capacity of protectors.

[5] Wis. Stat. §701.0818(2)(b)

[6] S.D. Codified Laws §55-1B-4.

[7] S.D. Codified Laws §55-1B-6

[8] See, e.g., Lewis v. Hanson (DE 1957): advisor is a fiduciary, analogous to a "quasi-trustee"; Harrington v. Bishop Trust (HI 1959): advisor is bound to fiduciary duty when voting stock; Crocker-Citizens Nat'l Bank v. Younger (CA1971): rights & duties of trustees generally apply to others who hold "trustee-like" powers; and Stuart v. Wilmington Trust (DE 1984): the power to consent to the trustee's exercise of a power is fiduciary in nature. As a counterpoint to these cases, compare Rob't T. McLean Irrevocable Trust v. Ponder (MO 2013) in which the court found that where the trust did not provide any requirement for the trust protector to supervise the trustee none would be implied by the court.

[9] Crocker-Citizens Nat'l Bank v. Younger (CA1971)