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

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SYNOPSIS

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I. Introduction to Directed Trusts

In a directed trust arrangement, the powers and fiduciary duties ordinarily vested in a trustee or equally across multiple co-trustees are divided and allocated among separate parties. These powers and duties relate to distributions, investments, or ministerial matters. One party, called a "trust director" under the Colorado Uniform Directed Trust Act ("CUDTA"), has the power to direct the trustee in the performance of a specific function or functions, and the trustee must comply with such direction. The trustee who is subject to the trust director's power of direction, called a "directed trustee" under the CUDTA, either lacks or has diminished authority to act regarding the functions allocated to the trust director. Because the directed trustee's authority to act with respect to the functions subject to the trust director's power of direction is reduced, so is the directed trustee's fiduciary duty and, therefore, potential liability.

A. Before Modern Directed Trust Statutes: The Common Law

At common law, a trust settlor could retain or grant to a third party the power to control the trustee in certain circumstances. This power could be exercised either by directing the trustee or requiring consent before the trustee could act. Section 185 of the *Restatement (Second) of Trusts* characterizes this power, as well as the trustee's fiduciary duty in complying, as follows:

> If under the terms of the trust a person has the power to control the action of the trustee in certain respects, the trustee is under a duty to act in accordance with the exercise of the power, unless the attempted exercise of the power violates the terms of the trust or is a violation of a fiduciary duty to which such person is subject in the exercise of the power.

The *Restatement (Third) of Trusts* bolsters this position. Under § 75:

> [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.

Thus, at common law, a directed trustee had a duty to comply with a trust director's direction, but the trustee retained a significant fiduciary duty: before complying, the trustee was required to 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* owed to the beneficiaries, essentially acting as a watchdog. A directed trustee could not escape being a trustee, even with

respect to functions specifically within the purview of a trust director. Modern directed trust statutes alter this regime.

B. Distinguished from Delegations

A directed trust does not involve a delegation of a trustee's authority. In a delegation, a trustee exercises his or her power to assign certain functions to a third party. *See, e.g.*, C.R.S. § 15-1-804(2)(x)(I) (providing that a trustee may employ attorneys or other directors to advise or assist the fiduciary in the performance of his or her duties or, instead of acting personally, employ one or more agents to do any ministerial act required to be done by the fiduciary in the performance of his or her duties). In so doing, 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. *See, e.g.*, C.R.S. § 15-1.1-109(a) (providing 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, consistent with the purposes and terms of the trust; and periodically reviewing the agent's actions in order to monitor the agent's performance and compliance with the terms of the delegation); and C.R.S. § 15-1-804(1) (providing that in exercising his or her powers generally, a fiduciary has a duty to act reasonably and equitably with due regard for his or her obligations and responsibilities toward the interests of beneficiaries and creditors, the estate or trust involved, and the purposes thereof). Rather, in a directed trust arrangement, because the trust director is specifically named in the terms of a trust, which vests him or her with specific authority over certain functions, the directed trustee's authority to act independently with respect to those functions is either reduced or eliminated. This lowers the directed trustee's fiduciary duty and potential liability.

C. Distinguished from Co-trusteeships

A directed trusteeship is not synonymous with a co-trusteeship. The powers and duties of co-trustees are generally held jointly: co-trustees are fully authorized to act in concert with respect to *all* trust functions, and are therefore obligated to discharge *all* fiduciary duties in their entirety. Thus, co-trustees generally remain fully liable for any breaches of trust. Conversely, in a directed trust arrangement, because the trust director alone is empowered to act with respect to certain functions, the directed trustee is disempowered as to those functions and therefore enjoys a reduced fiduciary duty and, concomitantly, reduced potential liability.

D. Focus of These Materials

These materials focus on private directed trusts created by individual settlors. Delegations of a trustee's authority and co-trusteeships are outside of their scope, as are directed trusteeships involving the federal Employee Retirement Income Security Act (ERISA).

E. Procedural Posture of the CUDTA

The Uniform Directed Trust Act (UDTA) was promulgated by the Uniform Law Commission in November 2017. A subcommittee of the Colorado Bar Association Trust & Estate Section's Statutory Revisions Committee (SRC) completed a thorough review of the UDTA in August 2018; the subcommittee's adaptation of the UDTA for Colorado, i.e., the CUDTA, was introduced on January 19, 2019, in the Colorado State Senate as Senate Bill 19-105. The Senate sponsor was Sen. Robert Rodriguez and the House sponsor was Rep. Kerry Tipper. The bill passed the Senate on February 11th, and passed the House on March 8th. It was sent to Governor Polis on March 19th, who signed it into law on March 28th. The CUDTA replaced Colorado's prior Directed Trustees statute at C.R.S. § 15-16-801 *et seq*., and took effect on August 2, 2019.

II. WHEN MIGHT A DIRECTED TRUST BE SUITABLE?

A directed trust can afford significant flexibility to trust settlors in achieving their goals. The following is a non-exhaustive list of scenarios in which a directed trust might be appropriate.

A. Investment of Trust Assets

1. **Professional Investment Advisor.** A settlor may have a long-standing relationship with a professional investment advisor whom the settlor wishes to manage trust assets for the settlor's beneficiaries but not assume any of a trustee's other duties. This structure carries with it the advantage of being able to change the trust's investment manager — say, 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.

2. **Beneficiary Management**. A settlor may desire that a beneficiary be responsible for managing a trust's investments, particularly if the trust has only one beneficiary and that beneficiary has demonstrated interest and competence in performing this function.

3. **Unmarketable or Illiquid Assets**. If a trust will be funded with any unmarketable or illiquid assets, such as real estate or a closely-held business, then a settlor may wish to vest one or more trust directors having particular expertise or knowledge with authority over those assets. This authority could include not only the power to manage the assets day to day, but also, for example, responsibility for obtaining proper valuations and/or deciding whether the assets should be retained in the trust. Naming a trust director for unique assets might also be appropriate if a corporate fiduciary serves as trustee, but 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 for which the trust director would have authority, but would retain full discretion over the trust's remaining assets.

B. Distributions

A settlor may wish to vest distribution decision-making authority in one or more persons who have knowledge of a trust's beneficiaries and their circumstances, but allocate all other fiduciary functions to a professional trustee. The trust director(s) responsible for distribution decisions might include family members or close family friends.

C. Ministerial Matters

A settlor may wish to allocate certain ministerial duties to a particular party, including, for example, valuing unmarketable assets, inspecting or properly insuring trust-owned real estate, or preparing the trust's tax returns and making appropriate tax reporting to beneficiaries.

III. ESTABLISHING A TRUST DIRECTOR'S POWERS AND DUTIES

A. Defined in the Terms of a Trust. The CUDTA does not contain any provisions, whether default or mandatory, that set forth a trust director's powers and duties. Rather, the *terms of a trust* define such powers and duties. "Terms of a trust" is a term of art under the CUDTA, and includes not only "the manifestation of the settlor's intent regarding a trust's provisions as . . . expressed in the trust instrument[,]" but also "as may be established by other evidence in a judicial proceeding." C.R.S. § 15-16-802(8)(a). The terms of a trust can 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 under the Colorado Uniform Trust Decanting Act, C.R.S. § 15-16-901 *et seq.*), or alternative dispute resolution. C.R.S. § 15-16-802(8)(b). Thus, in contrast to Colorado's prior Directed Trustees statute, which specified that only a *governing instrument*, defined as a will, trust agreement or declaration, or court order appointing a trust director, could create the director's powers and duties, the CUDTA provides a broader suite of means by which a director's powers and duties may be established.

B. Powers

1. Power of Direction. The CUDTA provides, generally, that "the terms of a trust may grant a *power of direction* to a trust director." C.R.S. § 15-16-806(1) (emphasis added). 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." C.R.S. § 15-16-802(5). It does not, however, include 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; 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; and several other powers. *Id.*, C.R.S. § 15-16-805(2). A power of direction cannot be exercised while a trust director is serving as a trustee. C.R.S. § 15-16-802(5).

2. **Further Power.** Unless the terms of the trust provide otherwise, a trust director may also exercise "any further power appropriate to the exercise or nonexercise of a power of direction granted to the director[,]"C.R.S. § 15-16-806(2)(a). Examples of such further powers include a power to:

> (1) incur reasonable costs and direct indemnification for those costs; (2) make a report or accounting to a beneficiary or other interested party; (3) direct a trustee to issue a certification of trust under Uniform Trust Code § 1013 (2000); (4) prosecute, defend, or join an action, claim, or judicial proceeding relating to a trust; or (5) employ a professional to assist or advise the director in the exercise or nonexercise of the director's powers.

Unif. Directed Trust Act cmt. 6 (2019).

C. Duties

1. **Same as a Trustee.** Under the CUDTA, 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." C.R.S. § 15-16-808(1)(a). Thus, the CUTC's default rules providing for the duties of loyalty, impartiality, prudent administration, and others, *see* C.R.S. § 15-5-801-812, as well as its mandatory rule establishing the duty to inform and report, *see* C.R.S. § 15-5-813, apply to trust directors. That the CUDTA expressly equates a trust director's fiduciary duty to that of a trustee provides clarity that Colorado's prior Directed Trustees statute lacked: the prior statute provided that a trust director must act in a fiduciary capacity, but did not delineate the extent of the fiduciary duty.

2. **Extent of Duty Can be Changed.** Unlike the prior statute, the CUDTA 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 trust 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." C.R.S. § 15-16-808(1)(b). However, the terms of the trust may impose on a trust director duties or liabilities that are beyond those imposed by the CUDTA, C.R.S. § 15-16-808(3), meaning that the CUDTA provides a mandatory floor.

IV. DIRECTED TRUSTEE'S DUTY TO COMPLY AND LIABILITY FOR COMPLYING WITH A TRUST DIRECTOR'S DIRECTION

A. Duty to Comply. The CUDTA provides that a directed trustee "shall take reasonable action to comply with a trust director's exercise or nonexercise of a power of direction . . . ." C.R.S. § 15-16-809(1). The 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. . . ." Unif. Directed Trust Act cmt. 9 (2019). 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.

Id.

B. No Liability for Complying. In complying with a trust director's direction, "the trustee is not liable for the action." C.R.S. § 15-16-809(1). This insulation from liability extends to the trustee's action in compliance with a further power appropriate to the exercise or nonexercise of the director's power of direction. *Id.*

C. Willful Misconduct Exception. The directed trustee's duty to comply has its limit: 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." C.R.S. § 15-16-809(2). This exception is consistent with Colorado's prior Directed Trustees statute.

1. "Willful Misconduct" Defined. In contrast to the uniform law, which sets forth the willful misconduct exception without further elaboration, the CUDTA defines the term: "'Willful misconduct' means intentional wrongdoing and not mere negligence, gross negligence or recklessness." C.R.S. § 15-16-802(11). This is verbatim the definition used in Colorado's prior statute. However, the CUDTA adds substance to this definition, providing that "'[w]rongdoing' means malicious conduct or conduct designed to defraud or seek an unconscionable advantage." C.R.S. § 15-16-802(12). Both of these definitions are drawn from Delaware's directed trust statute, upon which the UDTA's willful misconduct standard was based. *See* 12 Del. C. § 3301(g), (h)(4). They provide clarity, as well as a high bar to trustee liability, thus facilitating the use of directed trusts in Colorado: a trustee can know with greater certainty the extent of his or her potential liability when accepting an appointment.

2. Increased Total Fiduciary Duty Owed to Beneficiaries. In adopting the willful misconduct exception, the Uniform Law Commissioners expounded their rationale for doing so 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 and liability 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 terms of the power of direction 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.
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> Unif. Directed Trust Act cmt. 9 (2019).

3. **Mandatory Minimum Standard of Conduct.** The willful misconduct standard is a "mandatory minimum" under the UDTA and its Colorado adaptation, *id.*, meaning that it is not a default rule: 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." *Id.*

D. Trustee's Added Implicit Duty When Complying. Within the trustee's duty to comply with the trust director's direction, there appears to exist an implicit duty to determine whether the direction falls within the scope of the director's power of direction. If it does not, and the trustee acts upon an improper direction from the director, then the trustee could be left without the protection from liability that he or she expected to receive. The CUDTA provides a mechanism for achieving clarity in instances of uncertainty: a directed trustee who has "reasonable doubt" about his or her duty to comply may petition the court for instructions. *See* C.R.S. § 15-16-809(4). Thus, for example, if a trust director with a power of direction over investment matters directs the trustee to export all of the trust's assets to a bank in the Cayman Islands, the trustee could petition the court for instruction as to whether the director's power to direct trust investments includes expatriating the trust's assets.

V. DIRECTED TRUSTEE'S LIABILITY FOR A TRUST DIRECTOR'S INDEPENDENT ACTION OR INACTION

Colorado's prior Directed Trustees 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 trustee's liability for complying with a trust director's direction. This is consistent with the underlying premise of the Act, which presumes that a trust director does not act independently, but rather only through a directed trustee who acts in compliance with the director's direction. However, the Uniform Law Commissioners' comments to the UDTA state that the 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." Unif. Directed Trust Act cmt. 9 (2019). 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." *Id.*

VI. DUTY TO SHARE INFORMATION AMONG TRUST DIRECTORS AND TRUSTEES

A. Reciprocal Duties of Trustee and Director. Under the CUDTA, a trustee must share information with a trust director to the extent that it is "reasonably related both to . . . the powers or duties of the trustee[] and . . . the powers or duties of the director." C.R.S. § 15-16-810(1). Similarly, a trust director must share information with a trustee or another director to the extent that it is "reasonably related both to . . . the powers or duties of the director and . . . the powers or duties of the trustee or other director." C.R.S. § 15-16-810(2). The Uniform Law Commissioners explain the rationale for structuring the UDTA's information-sharing rules as between a trustee and trust directors 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.

Unif. Directed Trust Act cmt. 10 (2019). Thus, directed trustees and trust directors have reciprocal duties with respect to information sharing among themselves that are in parity with each other. This represents an improvement over prior law, which obligated the trustee to share information that was not related to his or her own responsibilities, resulting in potential liability for not sharing information that he or she should not have been expected to possess. *See* C.R.S. § 15-16-806(1).

B. Trustee's Duty to Provide Terms of the Trust. The CUDTA contains a provision not in the uniform law that requires a trustee to provide a copy of the terms of the trust to a trust director. C.R.S. § 15-16-810(5). The rationale for this added language is that disagreements could arise between a trustee and trust director as to what is reasonably related to the director's powers or duties, and the trustee might therefore withhold information from the director that the director believes he or she needs. The Act, therefore, allows all trustees and trust directors to have a copy of all of the trust's terms, so that they can have a full understanding of the totality of the trust's governing provisions.

VII. DUTY OF TRUST DIRECTOR TO COMMUNICATE WITH AND PROVIDE INFORMATION TO BENEFICIARIES

Unlike Colorado's prior Directed Trustees statute, the CUDTA does not contain specific provisions regarding a trust director's duty to provide information to beneficiaries. However, because the CUDTA 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[,]" C.R.S. § 15-16-808(1)(a), the trustee's statutory duty to provide information to beneficiaries under C.R.S. § 15-5-813 applies to trust directors to the same extent as it applies to trustees.

VIII. NO Duty to Monitor

The CUDTA provides that trustees and trust directors have no duty to monitor each other. This is a default rule, so it can be overridden in the terms of the trust: "Unless the terms of a trust provide otherwise . . . [a] trustee does not have a duty to . . . monitor a trust director," C.R.S. § 15-5-811(1)(a)(I), and a "trust director does not have a duty to . . . monitor a trustee or another trust director." C.R.S. § 15-5-811(2)(a)(I). This is consistent with the Act's general exculpation of a trustee, in the absence of willful misconduct, for complying with a trust director's direction regarding a matter subject to the director's power of direction, *see* C.R.S. § 15-5-809(1), (2); 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. *See* C.R.S. § 15-16-808(1). It 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.

- **Catch 22.** Like the UDTA, like the CUDTA contains an apparent catch-22 relating to a 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. How, realistically, could a trustee know of a trust director's nonexercise of a power of direction without monitoring the director? A nonexercise of a power constitutes a negative about which a trustee could not know, absent actual knowledge of the trust director's affirmative decision not to exercise his or her power or information constituting inquiry notice of the same. This knowledge could likely be obtained only through the trust director's express communication to the trustee, which the director is likely under no duty to make, or through the trustee's ongoing monitoring of the director's conduct. If a trustee could be liable for willful misconduct relating to compliance with a trust director's nonexercise of a power, does this imply that a trustee has a duty to take some action when faced with a nonexercise? If so, what is the nature of that duty? These are questions that are left open by the CUDTA as it is currently drawn, and it is likely that they cannot be answered until these provisions of the Act are interpreted by a court. Given the high bar to trustee liability inherent in the willful misconduct exception, *see* § IV.C.1, *supra*, this issue may be academic, but it theoretically exists.

IX. NO DUTY TO WARN

Unless the terms of the trust specify otherwise, under the CUDTA, a trustee has no duty to "inform 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." C.R.S. § 15-16-811(1)(a)(II). 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 trustee or another director. *See* C.R.S. § 15-16-811(2)(a)(II). This is a default rule that can be altered in the terms of the trust. The CUDTA fills a proverbial hole that existed in Colorado's prior Directed Trustees 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 trustee, but was silent regarding a similar duty on the part of the trustee. *See* C.R.S. § 15-16-806(4).

A. Relief from Duty May be Retroactive Only. Note the use of the past tense in the CUDTA's language: a trustee or trust director is relieved from a duty to inform or give advice to a beneficiary, settlor, trustee, or trust director regarding an instance in which the trustee or trust director might *have acted* differently. 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. The past-tense language used in the Act indicates that the exemption from the duty to inform or advise is retroactive — relating only to acts that have already occurred. Does a trustee or trust director retain a duty to inform or advise that is prospective in nature — relating to actions not yet taken, presumably 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 do not address this question, so an answer can only be provided by the courts.

B. No Assumption of Ongoing Duty. The CUDTA specifies that if a trustee gives information or advice to a beneficiary (or to a 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. C.R.S. § 15-16-811(1)(b). The Uniform Law Commissioners' comments to the UDTA support this: "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." Unif. Directed Trust Act cmt. 11 (2019). 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 trustee or another director. *See* C.R.S. § 15-16-811(2)(b).

X. 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. C.R.S. § 15-16-816. It also provides that by accepting an appointment as a trust director, the director "submits personally to jurisdiction in this state regarding any matter related to a power or duty of the director," C.R.S. § 15-16-815(1), and allows a trust director to petition the court for instructions under C.R.S. § 15-5-201(3). C.R.S. § 15-16-816.

XI. LIMITATION OF ACTIONS AGAINST A TRUST DIRECTOR

A. A**pplication of CUTC's Statute of Limitations under CUDTA. With the adoption of the CUDTA, the three-year statute of limitations that formerly applied to trust directors, C.R.S. § 13-80-101(1)(f), no longer does.** The Act 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." C.R.S. § 15-16-813(1).

B. Default 3-Year Limitations Period. 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 (a) the removal or resignation of the trust director, (b) the termination of the beneficiary's interest in the trust, or (c) the termination of the trust, *see* C.R.S. §§ 15-5-1005(3), 15-16-813(1), or against the trust director's estate within one year after his or her death. *See* C.R.S. §§ 15-12-803(1)(a), 15-15-103(8).

C. Reduced Limitations Period Available. A trust director may avail him- or herself of the CUTC's reduced limitations period, to wit:

> 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.

C.R.S. § 15-5-1005(1). The CUDTA confirms that "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." C.R.S. § 15-16-813(2). 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." C.R.S. § 15-5-1005(2). 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.

XII. DRAFTING AND PRACTICAL CONSIDERATIONS

Directed trusts present certain challenges that estate planners must consider when crafting estate plans and drafting trust instruments. Below is a non-exhaustive list of several such challenges.

A. Clearly Define Responsibilities. Because the fiduciary function is divided among one or more trustees and trust directors in a directed trust arrangement, it is essential to think through and clearly define in the trust instrument the functions being allocated and the powers that the trustee(s) and trust director(s) will need for a successful overall administration. Consider, for example, a directed trust in which responsibility for the investment of trust assets is given to a trust director. The following issues, and potentially others, should be addressed in the trust instrument:

- ***Will the Trust Director Act with Discretion?*** This is not as much of a drafting issue as it is a question that must be asked of a professional investment advisor before he or she should be nominated to serve as a trust director. In this context, "discretion" means that the advisor will execute purchases and

sales of 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, then he or she should not be nominated. The directed trustee, who might be seen as the "client" in the eyes of an investment advisor, will have no authority to act with respect to investments under the terms of the trust, and providing consent to securities trades would constitute an act outside of the trustee's defined powers. Thus, if the director were to ask the trustee to consent, the trustee would — and should — uniformly decline. Therefore, only investment advisors who will act with discretion should be nominated.

- ***Scope of the Director's Power.*** What is the scope of the director's power of direction — the investment of the trust's portfolio of marketable securities, or *all* trust property, including illiquid or unmarketable assets such as real estate, insurance policies, closely held business interests, etc.? If it is the latter, what if the trustee determines that the trust should purchase, as an asset of the trust, a house for the beneficiary to use as his or her primary residence, which would require the liquidation of a sizeable portion of the trust's liquid investments? Would the trust director be required to comply? Is the director willing to assume such responsibilities?
- ***Form of Directions.*** What form will the directions from the director to the trustee take? The trust instrument should specify a process for this, and indicate that all directions should be in writing. How will the trust director know that the trustee has received his or her direction?
- ***Custody of Assets.*** Who will have custody of the assets managed by the trust director — the trustee or the director — and are both agreeable to that arrangement? Many professional investment managers either insist on or have a strong preference for having custody of the assets they will manage. If the trust director will have custody, will he or she be responsible for properly allocating interest, dividends, and capital gains to principal and income in accordance with the Uniform Principal and Income Act? Does the director have the capability to do so? How will the trustee know that the director is not making distributions to beneficiaries, which is the responsibility of the trustee?
- ***Asset Valuation.*** Who is responsible for valuing the assets? Typically, if a professional investment manager is serving as the trust director responsible for trust investments, he or she should be responsible for valuing only the assets under his or her management.
- ***Trustee's Access to Funds.*** How will the trustee ensure that he or she has prompt access to the moneys needed to meet the distribution demands and expenses of the trust? The trustee should be empowered under the terms of the trust to direct the trust director to raise cash and tender it to the trustee when needed for such purposes, and the director should be required to comply. If the trustee can maintain a separate pool of funds from which to make distributions and meet expenses, how and where will those funds be invested, and who decides — the trustee or the trust director?
- ***Investment Policy Statement.*** The trust instrument should require that either the trust director responsible for managing the trust's investments prepare and

give to the trustee a written investment policy statement, or, if the trust director is a professional investment adviser and will not unilaterally prepare an investment policy statement without the agreement of a client, the director and the trustee 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 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 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 investment policy statement would let the trustee know what to expect, whether what the trust director plans to do is consistent with the director's power of direction, and whether the trust director's future actions fall within the director's own written rules.

Different questions or challenges may arise in different situations, so it is critical to analyze the nature of the directed trust at issue and specifically craft the trust instrument accordingly.

Planning Suggestion

At the outset of a directed trust relationship, it is advisable for the directed trustee and trust director to meet to identify the areas in which they will need to work together to discharge their respective obligations and the mechanics or logistics of how they will do so. Such matters could be technical or tedious, and it may not be practical or possible to describe them in the trust instrument. The topics discussed and decisions made should be memorialized in a written memorandum of understanding, to which the trustee and director can refer throughout the trust's administration. This memorandum can be revised from time to time, with the agreement of the trustee and director, as the administrative demands of the trust may require. The trust instrument can be drafted to require this process.

B. Select Trustees and Trust Directors Who Will Work Well Together. A directed trustee and trust director will need to interact with each other throughout a trust's administration. As previously discussed, the law requires the sharing of certain information between directed trustee and trust director in certain instances. Selecting persons for these roles who will be able to work productively together is critical for the success of a directed trust arrangement.

C. Plan for Director Succession. What happens if a trust director is no longer able or willing to serve, whether due to death, disability, resignation, or other cause? Will a successor trust director fill his or her role? Who will that person be? What happens if he or she declines to serve? If a successor director is not nominated in the terms of the trust or if a nominated person is unwilling or unable to serve, what is the process by which a successor will be selected? Are there any requirements or characteristics that the trust settlor wants a successor

trust director to meet or have in order to serve? Rather than appointing a successor trust director, should the trustee assume the director's functions?

Planning Suggestion

The trust instrument should always define a clear process by which a successor trust director will be selected. The goal is to never have a default in the trust director's role. If the trustee will assume the functions previously performed by a director, it would be wise to include in the trust instrument a provision allowing the trustee to consent within a reasonable time before doing so. The trustee agreed to serve as a directed trustee with respect to the functions performed by the trust director, and taking on those functions may constitute a material increase in the trustee's responsibilities. Depending on the trustee's skills or expertise, the nature of the functions performed by the director, and possibly other factors, the trustee may not be equipped or wish to assume that responsibility. If the trustee does not consent within a reasonable time or affirmatively declines to assume the director's responsibilities, then a new trust director would be appointed under a process defined in the trust instrument.

D. Should a Trustee or Trust Director be Given a Duty to Monitor or Warn? Although 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, practitioners should seriously consider the wisdom of doing so. As soon as a directed trustee or trust director are given a duty to monitor or warn, the directed trust structure breaks down and begins to operate more like a delegation in certain respects. This could lead to unintended consequences, including lack of willingness of fiduciaries to serve, increased costs, and even acrimony among fiduciaries, which could interfere with an efficient and orderly administration.

E. Consider Overall Fiduciary Fees. Generally, one should expect that the more fiduciaries one involves in administering a trust, the greater the overall fees chargeable to the trust will be. Thus, for example, in a directed trust where a professional trustee has been appointed, but responsibility for the investment of trust assets is given to a trust director who is a professional investment manager, two different fiduciaries will need to be paid. While the professional trustee may reduce his or her fee because of the reduced responsibility and risk, it is likely that when the trustee's and investment manager's fees are combined, the total fee will be higher than it would have been if a professional trustee capable of managing trust investments were appointed to serve as sole trustee of a non-directed trust. This is not to say that the directed trust arrangement is not preferable in a given case; a directed trust can afford great flexibility to a trust settlor with respect to involving the fiduciaries that he or she believes will best serve the purposes of the trust. One should, however, be mindful of the overall level of fiduciary fees that the trust will shoulder, as it can, over time, erode the funds available for the use or benefit of the beneficiaries.

F. Converting an Existing 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." C.R.S. § 15-5-111(1). These agreements do not need to be supported by consideration. *Id.* Required parties to a nonjudicial settlement agreement include "those persons whose interests in the trust would be materially affected by its provisions . . . ." C.R.S. § 15-5-111(2). However, persons who fall outside this definition are permissible parties to an agreement. 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 . . . ." C.R.S. § 15-5-111(3). Therefore, if at least all persons whose interests would be materially affected agree, and their agreement does not violate a material purpose of the trust and could be properly approved by the court, then an existing non-directed trust can be converted to a directed trust without court involvement. Such an agreement should address the types of issues discussed previously in this subsection, including the clear delineation of the responsibilities of the directed trustee and trust director and trust director succession.

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. *See* C.R.S. § 15-5-111(5), Colo. R. Prob. P. 24.

If a nonjudicial settlement agreement cannot be achieved, then conversion to a directed trust could be pursued through judicial modification under the Colorado Uniform Trust Code, C.R.S. § 15-5-411, or through decanting under the Colorado Uniform Trust Decanting Act, C.R.S. § 15-16-901 *et seq.*