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The Evolving Role of Trust Protectors

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INTRODUCTION

Over the last generation or so, trust protectors have invaded and tested venerable trust administration practices. Just when we thought we had started to figure out concepts of fiduciary duty and the always interesting dynamics between trustees and beneficiaries,

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trust protectors — the neither fish nor fowl of the trust world — have come along to permit grantors/settlors to haunt from the grave. With trust protectors, even trustees with virtually unfettered discretion may not control all the shots, because Big Brother or Big Sister may indeed be watching.

Trusts have traditionally involved three roles: (1) the grantor/settlor, (2) the trustee, and (3) the beneficiary. Yet estate planners today are frequently adding another party to the mix, the trust protector. Who are these trust protectors, who may be individuals or institutions (who of course are comprised of individuals)? There is no universal definition. Given that there is little case law discussing trust protectors, and that state statutes on the topic are inconsistent and often lacking, the trust protector remains somewhat of an enigma. In simplistic terms, a trust protector is someone given powers over a trust who is not a trustee. Trust protectors are utilized to add flexibility to the terms of a trust and increase oversight of trust administration.

EMERGENCE OF THE TRUST PROTECTOR

While opinions differ on the origins of the trust protector, the role gained popularity because of its use in offshore asset protection trusts. Specifically, to protect trust property from domestic creditors, grantors/settlors named foreign trustees. But these trustees were not subject to the jurisdiction of American courts and the grantors/settlors would thus cede control of property to an unfamiliar foreign trustee in order to obtain the asset protection. Many grantors/settlors were not comfortable relinquishing control and recourse in the event of problems.

Hence the trust protector. Appointing trust protectors to oversee the foreign trustees gave grantors/settlors additional assurance that the trustees would comply with the grantors/settlors' wishes and help protect against wrongdoing. Recognizing the value that trust protectors provided in offshore asset protection trusts, practitioners incorporated the role into domestic trusts.

TRUST PROTECTOR POWERS

Today, trust protectors are used to add significant flexibility to trusts, and grantors/settlors can give trust protectors a variety of powers to exercise. While including as many powers as possible could be tempting, very broad powers can lead to conflicts between parties and other complications. Practitioners and grantors/settlors should thus determine which powers best enable the protector to carry out grantors/settlor's intentions.

Grantors/settlors can authorize trust protectors to provide advice to trustees on a variety of matters related to trust administration, including advice on investment decisions, on discretionary distributions, and on what information to provide to qualified beneficiaries. This advice can be especially helpful if the trustee is not a professional trustee or is not financially savvy.

In addition, grantors/settlors concerned with the financial inexperience of trustees can appoint trust protectors to give more than advice and to actually oversee the trustee's actions. Grantors/settlors may give the trust protector the powers to direct, veto, or consent to investments or to distributions. Grantors/settlors may also grant trust protectors, particularly if the trust protector is an attorney or accountant, the authority to review and approve the trustee's accounting. This professional oversight protects the trust beneficiaries and helps insulate the trustees as well.

Grantors/settlors can give trust protectors the authority to interpret the trust upon the request of a trustee or beneficiary in order to resolve disputes among the parties. This authority can be binding or advisory. Granting this authority may prevent the parties from litigating and/or seeking instructions from a court in order to resolve disputes, thus minimizing expenses and, in theory anyway, contention. Trust protectors can also act as a mediator if there are disputes between trustees and beneficiaries or between co-trustees.

An important power granted to trust protectors is the authority to amend administrative provisions of the trust. This power is often limited to very narrow issues, such as modifying the trust to achieve a more favorable tax status, or to take advantage of subsequent changes in tax, trust, and probate laws. A trust may also empower the trust protector to change the governing law of the trust or move the situs of the trust to another state.

The trust may authorize the trust protector to modify the substantive provisions of the trust, including provisions affecting the rights of trust beneficiaries. This power may include the right to add or delete beneficiaries, the right to grant or modify a beneficiary's power of appointment under the trust, and

the right to terminate the trust and distribute the remaining property to the beneficiaries. A significant supervisory power is empowering the trust protector to remove and replace trustees without court approval.

ARE TRUST PROTECTORS FIDUCIARIES?

One of the most confounding issues concerning trust protectors is whether or not trust protectors have a fiduciary duty. While the short answer is generally yes, there are several arguments in favor of not holding a trust protector to a high fiduciary standard.

In general, a fiduciary duty requires that a fiduciary, e.g., a trustee, act with the utmost good faith and fair dealing towards beneficiaries. A fiduciary must sublimate his or her personal interest in favor of beneficiaries. A fiduciary must refrain from conflicts of interest, must not commingle assets, and must not take advantage of opportunities to the detriment of the beneficiaries. A prudent fiduciary will promote transparency, engage in communications about material aspects of the trust administration, and make every effort to treat beneficiaries equitably (although not necessarily equally).

Determining whether a trust protector has a fiduciary duty may depend on the language of the trust or any governing statutes. In many states the question is unsettled. Although counterintuitive, there are a handful of arguments why a trust protector should not have a fiduciary duty. A trust protector, after all, is not a trustee. When it comes to trust administration matters, the proverbial buck stops with the trustee. If the trust protector indeed has a high standard of fiduciary duty and the legal vulnerabilities associated with the duty, enlisting trust protectors to serve could be difficult. Since many of the powers of a trust protector are more like a grantor than a trustee, one could argue that it is the trust protector's job to set the stage for certain trust objectives, and it remains the trustee's job to implement those objectives.

However, there are many reasons why a trust protector should have a fiduciary duty. A trust protector may have significant power to implement the intent of the grantor/settlor, the interests of beneficiaries, and the conduct of a trustee. Interested parties, typically the beneficiaries, should be, as the name indicates, *protected* by the trust protector. With such important responsibilities, there should be a concomitant standard of care that requires the protector to adhere to a high standard of conduct.

To be effective, a trust protector must perform with care and expertise, and needs the respect of individual or corporate trustees as well as the beneficiaries. Similarly, courts may not accept the discretion of a trust protector who does not have a fiduciary duty. Courts,

trustees, and attorneys who in any way draft, administer, or litigate trust issues understand what fiduciary duty is. If a trust protector is not a fiduciary, then what principles govern his or her conduct? Not surprisingly, courts tend to be biased towards finding a fiduciary obligation.

Most states that have ratified the use of trust protectors have incorporated the language of §808(b) through §808(d) of the Uniform Trust Code (UTC) — an influential model for the governance of donative trusts. This section incorporates three elements of liability. First, a trust protector (as one with the “power to direct”) is presumed to be a fiduciary. This default position is supported by the common sense recognition that “the holder of the power to direct is frequently acting on behalf of others,” and thus “presumptively acting in a fiduciary capacity.” Second, the language defines *to whom* this duty is owed: a protector must act in good faith relative to (1) the purposes of the trust, and (2) the interests of the beneficiaries. Third, it outlines trustee liability in circumstances where the trustee must act pursuant to the protector’s authority. Many states refer to trustees in this position of forced compliance as “excluded fiduciaries,” meaning fiduciaries “outside” or “beyond” their purview of authority and within someone else’s authority; thus, they are subordinate to directives of the trust protector. A trustee is thus exculpated as an “excluded fiduciary” provided (1) such instructions are not manifestly contrary to the trust terms, and (2) the trustee has no knowledge that the “exercise would constitute a serious breach of a fiduciary duty” by the trust protector to the beneficiaries.

Using the UTC model, many states have recently codified the role of trust protector. Of paramount significance is the issue of protector as fiduciary. States have overwhelmingly favored the rationale of the UTC and its “presumed fiduciary” language. A few insular jurisdictions, however, have enacted an inverse standard. Their default position is that “trust protector[s] [are] not liable or accountable as a...fiduciary.” These jurisdictions — including Alaska,¹ Arizona, and Idaho — are outliers among states which have ratified protectors. The vast majority — including Kansas, Florida, Arkansas, South Dakota, Idaho, North Carolina, Wyoming, Michigan, Maine, Alabama, Tennessee, and Wisconsin — adopt the “presumed fiduciary” standard.²

State trust codes are consonant, however, in their codification of UTC §808’s liberal drafting policy.

¹ Alaska Stat. Ann. §13.36.370(d) states that “[s]ubject to the terms of the trust instrument, a trust protector is not liable or accountable as a trustee or fiduciary because of an act or omission of the trust protector taken when performing the function of a trust protector under the trust instrument.”

² Wyo. Stat. Ann. §4-10-711 states that “[t]rust protectors are

States almost unanimously defer to the language of the grantor/settlor in the trust instrument to define the relationships of its agents. This deference allows grantors/settlors to draft around default settings by applying or striking fiduciary language. A grantor/settlor can thus custom tailor positions of the trust organization depending on trust objectives.

Like a trustee, a trust protector may have a fiduciary duty that is discretionary. For example, a trust protector may have the authority to remove a trustee, but he or she may choose not to execute such power. If a trust protector has a fiduciary duty, the action would not be subject to legal challenge, absent bad faith or demonstration that the conduct somehow breached a fiduciary duty.

If a trust protector does not have fiduciary duty, then what is the authority to act and what standard governs the action? With no fiduciary duty, then the trust protector may indeed have personal powers and may act for his or her own benefit unburdened by the grantor’s intent or the interests of other beneficiaries. Without the fiduciary standard, a trust protector may not even be bound by fairness or reasonableness. If the trust protector does not have a fiduciary duty and only has personal powers, his or her only duty is to avoid fraud on the power, such as exercising legitimate power for an unauthorized person.

If a trust protector engages in controversial behavior, then the grantor/settlor (if he or she is still around), beneficiaries, or a trustee may enforce the standard. In any litigation, the court ultimately must assess and adjudicate the trust protector’s conduct and ascertain the standard of conduct and whether there has been a breach of that standard.

In the absence of a fiduciary standard, remedies for misconduct are more challenging. When any potential plaintiff seeks damages, the wrongful conduct and resulting harm typically must arise from some sort of breach. Equity may be necessary to fix problems associated with a trust protector’s somewhat amorphous role if the trust protector does not have a fiduciary duty. If a trust protector without a fiduciary duty engages in misconduct, equitable actions such as a complaint for declaratory judgment, injunctive relief, unjust enrichment, or for specific performance might be necessary to compel or stop certain actions. Remedies such as disgorgement or surcharges, sometimes meted out to fiduciaries, may also be on the table.

Many trust protector provisions and trusts attempt to limit liability of trust protectors. Drafting options could include mandates that the trust protector act in good faith, not be liable unless grossly negligent, not

fiduciaries to the extent of the powers, duties and discretions granted to them under the terms of the trust instrument.”

be liable unless he or she engaged in fraud, and not be liable unless he or she engages in willful misconduct. These provisions may not be enforceable. Typically, a protector cannot avoid liability for bad faith or reckless indifference to the purpose of a trust. Although it is common to try to draft around liability, a grantor/settlor must consider the prudence of doing so. After all, does the grantor really want to confer almost unfettered power to a trust protector? Can the grantor/settlor reconcile the need for a protector with the absence of a well-defined duty? In order to hedge against a trust protector acting arbitrarily or only in self-interest, the grantor/settlor and trust instrument should define the standard of conduct. Comprehensive drafting will generally require that the trust protector be held to at least a reasonably prudent person standard.

Rightly so, there is a legal bias that favors the best interests of the beneficiaries. For example, many courts will impose fiduciary duty statute of limitation on claims against trust protectors. Even if there is a desire to limit liability, as is common with trustees, the best practice is to define the protector as a fiduciary and let his or her actions be subject to scrutiny of well-defined fiduciary principles.

TRUST PROTECTOR CASES

Certain cases that highlight important considerations when assessing the role of trust protectors.

*Minassian v. Rachins*³ was a Florida case involving a trust protector's authority to amend the trust. In *Minassian*, the settlor established a trust providing that upon his death, his wife became the sole trustee and sole beneficiary during her life. The settlor's children from a prior marriage filed suit against the wife arguing that she was breaching her fiduciary duties and improperly administering the trust. The wife countered that the children were not beneficiaries of the current trust and that their interests were in trusts to be created after her death.

After the children's suit survived a motion to dismiss, the trustee appointed a trust protector as allowed in the trust. The trust authorized the trust protector to modify or amend the trust in order to correct ambiguities or drafting errors in order to protect the grantor's intent. The trust protector amended the trust to clarify that the children were not current beneficiaries with standing. The children then sought to have the trust protector's amendments declared invalid.

The lower court found in favor of the children, holding that the trust was unambiguous and that the trust protector had no authority to amend the trust.

³ 152 So. 3d 719 (Fla. Dist. Ct. App. 2014).

The *Minassian* court reversed, finding that the trust was indeed ambiguous and the trust protector's modifications were made to effectuate the grantor's intentions. The amendment was therefore within the trust protector's powers. Importantly, the trust protector's:⁴

amendments may have disadvantaged the children, but the trust protector was authorized the correct ambiguities with the limitation that he act either to benefit a group of beneficiaries or to further the husband's probable wishes. He acted to correct ambiguities in a way to further the husband's probable wishes. . . It was the settlor's intent that, where his trust was ambiguous or imperfectly drafted, the use of a trust protector would be his preferred method of resolving those issues. Removing that authority from the trust protector and assigning it to a court violates the intent of the settlor.

The South Carolina case *Schwartz v. Wellin*⁵ held that a trust protector lacked standing to engage in litigation regarding the trust. In *Wellin*, the trust protector had removed and replaced the trustee and further sought to amend the trust in various ways, including a new provision stating that the trust protector had standing in litigation involving the trust. The trust protector petitioned for appointment of a *guardian ad litem* to represent the interests of unborn or unascertained beneficiaries; other beneficiaries objected. The court held that the trust protector did not have standing as a real party in interest.⁶ The court noted that there was no state case law supporting that argument that a trust protector qualifies as a real party in interest, as well as the fact that the trust protector did not demonstrate that he personally suffered an actual or threatened injury.⁷

The court also invalidated the trust protector's proposed amendment giving the trust protector standing in litigation involving the trust. The court noted that the trust protector's power to amend the trust did "not allow the trust protector to unilaterally expand his powers. As a result, the Litigation Provision, which increases rather than decreases the trust protector's powers, must be invalid."⁸

In *Carberry v. Kaltschmid*,⁹ an unreported California case, the court held that the trust protector lacked standing and could not obtain an accounting. The trust

⁴ *Minassian*, 152 So. 3d at 727.

⁵ No. 2:13-CV-3595-DCN, 2014 BL 107668 (D.S.C. Apr. 17, 2014).

⁶ *Wellin*, 2014 BL 107668 at 6-7.

⁷ *Wellin*, 2014 BL 107668 at 6-7.

⁸ *Wellin*, 2014 BL 107668 at 8.

⁹ No. A150675, 2018 BL 202031 (Cal. App. 1st Dist. June 7, 2018).

stated that the trust protector served “in a fiduciary capacity” and was granted several powers, but that only two of the powers arguably requiring any routine monitoring activity, a small-trust termination power and a change-of-situs power. The court stated that non-beneficiary trust protectors are not entitled to compel accountings, unless the trust document states otherwise, which in this case the trust did not.

The *Minassian*, *Wellin*, and *Carberry* decisions highlight that trusts should grant express powers to trust protectors. Practitioners should spell out the authority and responsibilities of trust protectors in the documents. Many states do not have laws regarding powers and responsibilities of trust protectors and those states that do have them are not consistent. Given the uncertain status of the trust protector across the country, the best way to reflect and protect the trust protector’s powers is to carefully describe powers in the trust document.

In the 2015 Louisiana case *In re Eleanor Pierce (Marshall) Stevens Living Trust*,¹⁰ the settlor amended her trust to provide for a trust protector. The amendment gave the trust protector the authority to remove a trustee. The trust protector removed the trustee, who then appealed the removal. The trustee argued that the office of trust protector violated public policy, in part because it would make the trustee accountable to the trust protector and potentially cater to the trust protector’s wishes even if the trustee believed those wishes diverged from the wishes of the beneficiaries and the settlor.

The court rejected the argument that the position of trust protector violated public policy. While acknowledging that the trustee may be accountable to the trust protector, the court noted that the trust protector nonetheless served important functions. The court stressed that beneficiaries are typically responsible for making sure that the trustee properly administers the trust and adheres to a settlor’s intentions, and that filing an action for breach of fiduciary falls on the beneficiaries.¹¹ But the responsibilities of beneficiaries are “not fool-proof. Beneficiaries may not have the expertise to determine whether there has been a breach. Additionally, beneficiaries may be reluctant to take action for any breach detected, as they are, often, dependent on the trustee. Finally, in an action for breach, the trust beneficiaries will bear much of the litigation cost.”¹² The court concluded that appointing a trust protector removes the onus of monitoring the trustee and taking action following any breaches of fiduciary duties from

the beneficiaries and places it into the capable hands of the trust protector.

In *Robert T. McLean Irrevocable Trust v. Davis*,¹³ the successor trustee of a trust sued the former trust protector for alleged breach of his fiduciary duty resulting from the trust protector’s failure to remove former trustees who were improperly spending trust funds. The trust was a special needs trust holding the settlement proceeds awarded to the beneficiary after a car accident rendered him a quadriplegic. The case alleged that the trust protector knew that the previous trustees were wastefully spending funds and, accordingly, had a duty to remove them.

Since state law did not impose any specific duties on trust protectors, the court looked to the language of the trust to determine the settlor’s intent in appointing a trust protector. The court noted that the trust gave the trust protector authority to remove and replace trustees in a fiduciary capacity and that the trustee had the power to reject a removed trustee’s designated successor. The court determined that the settlor might have intended that the trust protector fulfill his duties as fiduciary capacity. The appellate court remanded the case to the trial court to determine whether the trust protector was a fiduciary and, if so, whether he had breached his fiduciary duty. Despite leaving many unanswered questions, *McLean* demonstrates the importance of defining the fiduciary duties of the trust protector, particularly where state law does not impose duties or provides that trust protectors presumptively act in a non-fiduciary capacity. *McLean* also shows the weight that courts give to the intent of the settlor. The court looked to the trust’s language and powers given to the trust protector in order to try to circumscribe the expectations of the trust protector.

CONCLUSION

While increasing in popularity, trust protectors are still somewhat rare and the legal concepts governing their role remains murky. But amidst the uncertainty, grantor/settlors, and their attorneys, in appropriate and perhaps complicated situations, should consider trust protectors to add flexibility and little added insurance to trust administration. When preparing trusts involving trust protectors, drafters must understand the differences among state laws as well as ambiguities in the law. Drafters should clearly state which powers are granted to the trust protector and the duty of care owed. And all parties, as in most trust matters, must consider the intent of the grantor/settlor and interests of the beneficiaries first and foremost.

¹⁰ 159 So. 3d 1101 (La. Ct. App. 3d Cir. 2015).

¹¹ *In re Eleanor Pierce*, 159 So. 3d at 1110.

¹² *In re Eleanor Pierce*, 159 So. 3d at 1111.

¹³ 283 S.W.3d 786 (Mo. Ct. App. 2009).