# Open Architecture Trust Designs under New Hampshire Law Provide Flexibility and Opportunities


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## A. INTRODUCTION

An article recently appeared in the *Wall Street Journal*[1] in which the author observed that "…as trusts become more complex and investing strategies become more sophisticated, more well-off families are using teams of multiple trustees and advisors, each with very specific roles and responsibilities…Families are 'slicing and dicing' trustee duties, and allocating them among these multiple trustee and non-trustee participants…", including co-trustees, agents, trust "protectors", distribution and investment committees and trust "advisors".[2]

You know that an estate-planning concept has achieved some currency when it moves beyond the arcane world of the professional journals and into the popular press. In recent years, many commentators have addressed the nuanced legal issues implicated by such multiple participant open architecture trust ("OAT") structures – a modern development unknown to the common law.[3] New Hampshire is one of a modest but growing number of states that have responded by enacting statutory default rules governing the interrelationship and legal responsibilities of these new players to each other, to trustees and to beneficiaries. New Hampshire first adopted the OAT features of the Uniform Trust Code ("UTC") in 2004 without significant changes to the Model UTC.[4] In 2006, the New Hampshire overhauled those provisions with several important amendments and enhancements made as part of the "Trust Modernization and Competitiveness Act" ("TMCA"). New Hampshire's legislation has been hailed as the most comprehensive and thoughtful of the available statutory templates, and is likely to influence trust reforms in other states.[5]

OAT structures offer both promise and peril for estate planning attorneys, trustees and clients alike. They can be crafted to allow families more meaningful roles in the administration of their large trusts and address many of the constraints and liability risks trustees faced under prior law (particularly those relating to investments and the duty of diversification). However, there remains the potential for unintended tax and other consequences as the law and drafting practices continue to evolve. This article will attempt to trace the origins of these new models for trust governance and explore some of their implications for trust drafters, clients and trustees.

## B. ORIGINS OF OPEN ARCHITECTURE TRUST DESIGN

### 1. The "Unitary Trustee" and the Non-Delegation Principle[6]

**a. Feudal England**. Trusts were originally developed in England as a means of conveyance of feudal lands, not as a vehicle for the management of fungible investment assets. The trust structure evolved as a title holding intermediary to avoid restrictions on land ownership and inheritance that existed under the ancient English law of real estate. Achieving these purposes required that trustee hold full legal title to the land. Accordingly, English common law protected the family by severely limiting the authority of the trustees. The chosen trustees were typically individuals: friends, advisors and members of the family. These early trustees served without compensation and did very little. There was no need for elaborate trust laws to define the powers of trustees and the interrelationship between the family and trustee because they peacefully co-existed within their limited spheres.

**b. Post-Industrial England**. The need for a deeper body of trust law became more apparent after the industrial revolution. Financial instruments – stocks, bonds and other complex financial promises – replaced real estate as the primary stores of private wealth. Traditional family trusts in England remained anchored in by their heritage as simple devices for holding and conveying real estate. The trustee's inherent powers continued to be limited despite dramatic changes in financial assets. The law continued to require that a single trustee, or multiple trustees acting unanimously, take all important

trustee actions and participate in all significant trust decisions. Generally, critical trustee functions such as investing or distributing assets among beneficiaries could not be delegated to one of several trustees without the others retaining some responsibility for their co-trustees' misdeeds and breaches of fiduciary duties. The "unitary trustee" with limited powers, and the subsidiary principle prohibiting delegation, were generally immutable; they could not be overridden by the trust creator by a contrary instruction in the trust agreement. The early English common law, therefore, recognized only a single, integrated office of trustee.

**c. United States**. The unitary trustee principle was carried over from England to the crown colonies, including the United States. It initially proved resistant to reform despite a rapid evolution in financial and investment management practices that mandated more flexible conventions. American courts and some legislatures gradually responded first by replacing the concept of protecting beneficiaries by limiting trustee powers with a new system that granted broader powers, but restricted their exercise by imposing strict duties of fiduciary prudence and loyalty.

Another watershed development in the evolution of the law of trusts and trustees: the rise of the institutional trustee-for-hire. State and federally-chartered corporate trustees began to supplant the uncompensated lay trustee by the end of the 20th century. U.S. tax law helped accelerate this trend because many trustee powers – particularly dispositive powers – could trigger adverse federal estate tax consequences if they were held by settlors and related beneficiaries. Corporate trustees found comfort in the unitary trustee rule because it tended to protect their near monopoly position and give them disproportionate powers over substantial family trusts. Dissatisfaction with this situation, coupled with a desire on the part of family members to assert more control over their trusts, began to erode the unitary trustee principle and the dominant position of the corporate trustee. Other more recent developments have also contributed: a growing sophistication and complexity in the investment world, the decline of the rule against perpetuities and the resulting growth in dynasty trusts, vigorous competition among states for trust business, rapid consolidation and merger among financial institutions (including banks with trust departments) and dramatic recent changes in trust laws.

## 2. Gradual Erosion of the Unitary Trustee Concept

**a. Evolution of the Laws Applicable to Co-Trustees**. The use of non-trustee participants was not widespread in this country until the last decade or so. Before then, the movement away from the traditional fully empowered unitary trustee model began with the increased use of co-trustees. Co-trusteeships first became popular to overcome the inability of a single trustee to administer property in multiple jurisdictions (*i.e.*, where the primary trustee was not legally competent to act outside of the state of its residence or charter). Later, co-trustees provided specific competence not possessed by the primary trustee – for example, the use of "special trustees" to administer closely held business assets, or to participate in distribution decisions that an "interested" primary trustee could not make without risking adverse wealth transfer tax consequences. The increased use of multiple trustees forced changes in the law concerning the duties and responsibilities of co-trustees among themselves and with respect to the beneficiaries in several noteworthy respects that were instrumental in the development of the laws relative to non-trustee OAT participants.

**1. Allocation of Responsibilities**. Generally, if the terms of a trust with more than one trustee provide that one or more of the trustees will possess exclusive authority with respect to trust administration, the other trustee ordinarily has no duty to participate in the matters exclusively delegated to the empowered trustee.[7] If, however, a non-participating trustee believes that the empowered trustee may be committing a breach of trust, the non-participating trustee has a duty to take reasonable steps to investigate and prevent a breach, if possible.[8]

**2. Trustee Action**. The common law "default" rule initially required unanimous decision-making among co-trustees.[9] The law evolved over time and replaced the unanimity requirement with a majority rule standard.[10] A deadlock among trustees could only be resolved by court intervention.[11] These were default rules that could be modified by specific provision in a trust agreement. For example, even if a document empowered one of many co-trustees to decide specified questions or take actions as "controlling trustee" in the event of deadlock, the courts required that all trustees participate in decision making with respect to those matters and to be an informed fiduciary participant in all trustee deliberations (including those exclusively delegated to another co-trustee).[12] This is sometimes referred to as a "duty to consult".[13] The duty of each trustee to use reasonable care to prevent a breach by the controlling trustee was considered to be non-waiveable by a contrary instruction in the trust agreement.[14]

**3. Co-Trustee Liability.** Co-trustee liability is generally joint and several.[15] A co-trustee is not liable to a beneficiary for a breach of trust committed by another trustee unless such co-trustee: (i) participated in the breach; (ii) improperly delegated the administration of the trust to the acting trustee; (iii) approved, acquiesced in or concealed the breach; (iv) through failure to exercise reasonable care in the trust's administration, enabled the co-trustee to commit the breach, or (v) neglected to take proper steps to compel the acting co-trustee to redress the breach.[16] Thus, by common law, most jurisdictions did not allow a trustee to avoid liability merely by remaining inactive in the administration of the trust. When a co-trustee dissents, however, the dissenting trustee is often able to avoid liability.[17]

**b. The Influence of Prudent Investor Legislation**. The death knell finally sounded for the rules prohibiting delegation of trustee functions with the states' adoption of legislation modeled after the Uniform Prudent Investor Act ("UPIA") first promulgated in 1992. The UPIA reflects "modern portfolio theory" and a total return approach to the exercise of trustee investment powers and discretions. Most states have enacted some form of the UPIA that allows the trustee to acquire most types of investments, as opposed to the "traditional" trustee investment laws, such as the "prudent person standard", which limited choices among conservative alternatives said to be of "trust quality".[18] The UPIA measures investment performance by assessing the entire portfolio, replacing the asset-by-asset analysis required by

the predecessor prudent person standards.[19] UPIA's "prudent investor" standard may *require* trustees to delegate investment authority to co-trustees or agents if the trustee does not have sufficient expertise to perform that function for a particular trust. Even a trustee with investment skill may delegate certain investment functions.[20]

**3. The Emergence of "Directed" and "Delegated" Trust Arrangements**. Perhaps more than any other development, the wholesale adoption of prudent investor standards has fueled the popularity of what have come to be known as "directed" and "delegated" trusts. These terms are sometimes incorrectly used interchangeably. Each of type trust has, however, important characteristics that distinguish one arrangement from the other.

**a. Delegated Trusts**. Generally, a "delegated trust" is one in which the trustee hires a third party to perform some or all of the trustee's discretionary investment management functions. The relationship of the delegating trustee and the third party is generally one of principal and agent. The trustee of a delegated trust has a duty to select the investment manager with care, and to exercise prudence in monitoring the manager's activities.[21]

**b. Directed Trusts**. A directed trust, by contrast, strips from the trustee all discretionary duties – whether related to investment management, discretion over distributions to beneficiaries, or both. A directed trustee, also often referred to as an "administrative trustee", generally has no duty other than to follow the directions of the empowered party. The empowered party's powers to direct are expressed in the trust agreement. Unlike the delegated trustee, the directed trustee does not have any selection or monitoring responsibilities. The directed trustee's only obligation is to insure the accomplishment of the settlor's intent as expressed in the trust agreement.

**4. Recognition of OAT Structures in the Uniform Trust Code**. As indicated above, before the enactment of directed trustee statutes, the few courts that had occasion to address the issue generally found that a trustee would not be held liable for following the instructions of a person empowered by the trust instrument. They had trouble, however, defining the extent, if any, of a directed trustee's affirmative duties to the beneficiaries. A consensus emerged from the few decided cases: the trustee must insure that following those instructions does not violate the trust agreement or fiduciary duties owed to the beneficiaries, and must intervene to prevent a breach (or at least warn the beneficiaries so that they themselves can take timely action)[22]. Although the legislatures have been slow to codify and improve on this narrow and sometimes conflicted body of common law, from the beginning the Model UTC recognized that a regime imposing duties to investigate and intervene does not always make sense in light of the increased use directed and delegated trust arrangements.[23]

## C. THE ANATOMY OF A MODERN OAT DESIGN

**1. Drafting: The Perils of Relying Exclusively on Statutory Default Rules**. New Hampshire and a few other "progressive" trust jurisdictions have taken the lead in going beyond the UTC's limited recognition of directed trusts with comprehensive statutory default rules that answer several questions concerning a directed trustee's residual responsibilities that the UTC failed to address. Still, the estate planning attorney charged with drafting a modern directed trust under the New Hampshire legislation (or the laws of any other states, whether or not the governing law expressly sanctions OATs) will be careful to craft the trust's provisions to remove the passive trustee's duties and discretions as to distributions and/or investments and give them to an investment committee/trustee, distribution committee/trustee, and/or trust advisor or trust protector. Generally, it is best not to leave these issues to the default rules.

**2. Defining the Participants and Their Respective Roles**. The directed trustee's duties should specifically be defined -- for example, to include taking title and ownership of the trust assets, establishing and maintaining a trust bank account, preparing or signing the trust tax returns, preparing and sending trust accountings and other statements, making distributions and receiving contributions, as directed by the empowered party. The directed trustee also will orchestrate things among the multiple participants so that the provisions of the trust agreement are strictly followed.

What follows is a sampler of the usual participants in a modern directed-trust structure.

**a. Investment Committees and Advisors**. The participants possessing specifically allocated investment powers are typically the settlor's family members, investment advisors, consultants and investment management professionals. Often they work together and comprise an "investment committee" that provides directions to the directed trustee. The investment committee often will manage insurance, closely held stock, partnerships, LLCs, real estate, art, commodities, vacation homes and other illiquid "special assets" that may be held in the trust.

**b. Distribution Committees and Advisors**. Discretionary distribution decisions often are handled in a similar fashion. The trust agreement will establish a distribution committee composed of both family and independent members. The independent members are important for avoiding the imputation of wealth transfer tax-sensitive discretionary actions to committee members who are beneficiaries. Such tax sensitive distributions generally require a non-related or subordinate person to make discretionary distributions to keep the trust assets out of the trust settlor's and the beneficiaries' gross estates under the federal estate tax laws.

**c. Trust Protectors**.[24] Trust protectors are often used in tandem with directed trusts' investment and distribution committees. Estate planning attorneys in states without trust protector statutes are drafting the trust protector function into trust agreements governed by the laws of those states (although such structures may be riskier for the directed trustee and the trust protector in states that do not specifically recognize the office of trust protector).

A trust protector typically is given one or more of several duties:

- Amend or modify the trust agreement to achieve favorable tax consequences or respond to changes in the tax laws;
- Amend or modify the trust agreement to take advantage of laws relating to the administration of the trust, restraints on alienation, and the distribution of trust property;
- Increase or decrease the interests of trust beneficiaries;
- Grant, revoke and modify the terms of beneficiary-held powers of

appointment;

- Remove and appoint trustees, trust advisors and investment and distribution committee members;
- Terminate the trust;
- Veto or direct trust distributions;
- Change the situs or governing law of the trust, or both;
- Appoint their own successors as trust protectors;
- Interpret ambiguous terms of the trust agreement as may be requested by the trustees; and
- Advise the trustee on matters concerning one or more trust beneficiaries.

## D. NEW HAMPSHIRE'S ROBUST OAT LEGISLATION AND THE DUTY TO DIVERSIFY TRUST INVESTMENTS

New Hampshire's OAT statutory provisions are particularly effective in addressing the responsibilities and liabilities of trustees who are directed to hold concentrated equity positions and illiquid assets. Some background is helpful in understanding this issue and New Hampshire's approach.

**1. Reconciling the Investment Diversification Requirement with the Modern Directed Trust**. Under most states' common law and statutory standards for trustee investments, diversification is essential to prudent investing. "Modern portfolio theory" ("MPT") is a creation of economists, in their attempt to understand the market as a whole, as opposed to individual investment opportunities. One of the time-honored principles of MPT is that portfolio risk can be reduced by diversification, which is often referred to as "the only free lunch". A portfolio is truly diversified only when it is made up of distinctly separate and broadly different asset classes – generally cash, stock, bonds, and perhaps real estate and "alternative investments" for larger trust portfolios. Studies have shown that asset allocation is the single most important factor in determining returns from investment.

Within the equity asset class, it takes at least 15 stocks, spread among five or six non-correlated sectors and issuers (domestic and international) to achieve adequate diversification and thereby reduce non-systemic risk (also referred to as "uncompensated risk").[25] Within a domestic equity portfolio, this refers to firm and industry specific risks – the risks of one company or economic sector causing a significant move, either up or down, in a portfolio.

Modern fiduciary investment standards, including those incorporated in New Hampshire's pre-TMCA statutes, adopted diversification as a bedrock principle for the prudent management of trust portfolios. Under these standards, it was clear that a trustee must diversify unless it is prudent under the circumstances not to. A New Hampshire trustee must have had a compelling reason not to diversify. These prudent investor rules were default rules and could be expanded, restricted, eliminated or otherwise altered by provisions of a trust. Such provisions are commonly referred to as exoneration, exculpatory or authorization provisions.

Under New Hampshire's pre-TMCA law, trustees could confront many thorny issues when dealing with provisions of a trust agreement that authorized or directed the retention of a concentrated stock position or an illiquid asset such as real estate or closely held business interest. The trustee and its counsel was forced to read and analyze these provisions carefully. In the context of the settlor's intent, the trustee was well advised to understand whether the trust instrument altered the trustee's authority, or standard of care, or both.

For example, did the trust document (i) authorize the trustee to refrain from diversifying the trust assets, thereby eliminating or diluting the normal diversification requirement, but (ii) remain silent on the standard of care by which the trustee's decision not to diversify may be reviewed?

As a general proposition, under the old rules in New Hampshire, an exculpatory, exoneration, or authorization provision could change the normal prudence standard by which the trustee's investment conduct was to be reviewed[26]. But a trust document that simply authorized the trustee to depart from the normal standards of prudent investing might not change that standard at all. In any given case involving a trustee's investment conduct and a failure to diversify, under pre-TMCA law, the same set of facts could lead to two very different results when the trust instruments varied slightly. Although the New Hampshire Supreme Court has not had specific occasion to address the diversification issue in the context of a concentrated trust portfolio, courts in several other states have, often resulting in surprisingly harsh surcharges against trustees.

As a general rule, courts will strictly construe an exculpatory, exoneration or authorization provision before relaxing the normal diversification requirement. Standing alone, a permissive provision in a trust agreement does not relieve a trustee from scrutiny under the prudent investor standard. *Indeed, to the shock and dismay of many in the fiduciary professions, trustees have been held liable for failure to diversify even in cases involving a direction in the trust document to retain a concentrated position or an illiquid asset such as real estate or a closely held business interest.*[27] Courts have found that such a direction does not excuse the trustee from a duty to monitor the investment and petition the local probate court for modification of the trust agreement if the asset in question substantially declines in value.[28] This has made it quite difficult for settlors and their drafting attorneys to negate or dilute the normal diversification requirements of prudent investing. Settlors also have difficulty finding corporate trustees to manage undiversified trust portfolios or retain real estate or closely held business interests that might comprise a disproportionate portion of a trust's value, irrespective of the extent of the authority, direction, or exoneration language contained in the governing document.

**2. New Hampshire's Solutions**. TMCA has removed many of these obstacles and provided cover for trustees holding undiversified trust investments by changing several provisions of the UTC.

**a. "Good Faith" Standard**. In 2004, the UTC repealed the prudent investor rule contained in RSA 564-A:3-b. The new investment standard was recodified as Article 9 of the UTC, which did not differ substantially from the former rule or the general standards of prudence and diversification described earlier in this section. Pre-TMCA §9-901(b) purported to protect the trustee from surcharge liability "to the extent that the trustee acted in reasonable

reliance on the provisions of the trust" (italics supplied) that altered or eliminated the duty to diversify. §9-903 provided that the trustee need not diversify if "the trustee reasonably determines that, because of special circumstances, the purposes of the trust are better served without diversifying." This language was taken verbatim from §903 of the Model UTC. The comments to Model UTC §903 offer examples of such special circumstances, including a trustee's consideration of the tax consequences of selling a large block of stock with a low cost basis, or a trust that is clearly designed to hold a family business or vacation home.

While the intention of the drafters of the Model UTC was to provide more cover from surcharge exposure, trustees and their counsel took cold comfort in these two exceptions to the normal diversification requirement. The "reasonable reliance" exception is an objective, "reasonable person" standard. It does not focus on any given trustee's subjective good faith reliance on a retention direction or authorization. Trustees operating under the reasonable reliance exception were still wary of the cases from other jurisdictions that surcharged trustees for failure to diversify despite a contrary direction or authority in the trust agreement. A New Hampshire trustee operating under former §§9-901(b) and 9-903 would have no certainty regarding the reasonableness of the trustee's reliance on the retention provision until after the beneficiaries' lawyers took their best shots and the surcharge litigation concluded with the presiding judge's application of 20:20 hindsight to the trustee's actions. It remained uncertain the extent to which a trustee could justify retention based on special circumstances, even if the facts fell within the examples (low cost basis, etc.) given in the comments to the Model UTC.

TMCA addressed these issues in part by amending §9-901(b) by adding the following italicized language: "A trustee is not liable to a beneficiary to the extent that the trustee acted in reasonable reliance on the provisions of the trust or court order *or determined not to diversify the investments of a trust in good faith in reliance on the express terms of the trust or a court order or pursuant to [§9-903]*" (italics supplied). This new language both specifically addresses the issue of a trustee's liability for failure to diversify and provides a subjective "good faith" standard for judging the trustee's conduct. A beneficiary seeking to surcharge a trustee for relying on a authority to retain under a governing instrument or court order have a formidable evidentiary burden: they now must show that the trustee acted in bad faith in following a direction or authorization not to diversify. Importantly, a court may find that a trustee's determination not to diversify was inappropriate and therefore may force the sale of a concentrated position, but the good faith standard will take the surcharge remedy out of play in all but the most egregious cases.[29]

**b. No Duties to Monitor, Investigate Direct or Warn**. TMCA also addresses the diversification problem by improving the former UTC provisions relating to directed trusts. Before the enactment of TMCA in 2006, the UTC recognized the use and validity of directed trusts by allowing settlors to confer trust functions on third parties, and ratifying the use of such third parties. RSA 564-B:§8-808(b) provided that if the trust agreement confers upon a third party the power to direct the trustee, "…the trustee shall act in accordance with the exercise of the power unless the attempted exercise is manifestly contrary to the terms of the trust or the trustee knows the attempted exercise would constitute a serious breach of fiduciary duty that the person holding the power owes to the trust beneficiaries." Former §8-808(d) provided that a third party with a power to direct is "presumptively…a fiduciary," with a duty to "act in good faith in regard to the purposes of the trust and the interests of the beneficiaries", and subjected that party to the corresponding liability for breaching a fiduciary duty.

While these provisions authorized generally the use of directed trusts, they were in many respects vague and uncertain in their application. TMCA addresses this in several respects: first, by providing some new definitions to the UTC's definition section, §1-103; and second, by enacting a comprehensive, bullet-proof new UTC Article 12 devoted exclusively to trust protectors and trust advisors. The 2008 amendments to the UTC reenacted Article 12 in its entirety, to provide additional clarity. Some highlights:

### 1. Definitions

**a. "Directed Trust."** RSA 564-B:1-103(23) defines a "directed trust" as a trust with respect to which one or more persons is given the authority to direct or consent to a trustee's actual or proposed decision, including investment decisions and decisions concerning distributions.

**b. "Excluded Fiduciary."** §1-103(24) defines an "excluded fiduciary" as a fiduciary who is excluded from exercising a power or who is relieved of a duty because such power or duty is vested in another person. This enables a settlor to confer investment authority, but no other authority, solely upon a trust advisor, to the exclusion of the trustee. With respect to investment decisions the trustee is an excluded fiduciary, and with respect to all other trust functions the trust advisor is an excluded fiduciary.

**c. "Trust Advisor" and "Trust Protector."** RSA 564-B:12-1201(a) defines "trust advisor" and "trust protector" and §12-1201(b) provides a non-exclusive list of functions (including investment management) that can be delegated to trust advisors. §12-1202 confirms that any trust advisor or protector (other than a beneficiary) is a fiduciary, subject to fiduciary liability for breaches of duties vested in the trust advisor or trust protector.[30]

**2. Exoneration of Directed Trustees**. §12-1204 provides that a trustee, as an excluded fiduciary, does not have a duty to review the actions of a trust advisor or trust protector, and §12-1205 insulates the trustee from liability for losses relating to duties vested solely in a trust advisor.

Taken together, these new provisions in UTC Article 12 provides tremendous comfort to directed trustees and eliminate the needless expense of trustee oversight. Trustees who wish to modify existing trusts to allocate to trust advisors or protectors responsibilities over investments and/or distributions may seek modifications to irrevocable trust agreements that shift those responsibilities to designated trust advisors or protectors, and state specifically that the directed trustee will be an excluded fiduciary. Such modifications are administrative in nature and should be the proper subject of a nonjudicial settlement agreement, unless unbundling the trustee duties in this fashion violates a

material purpose of the trust (such as evidence that the settlor reposed particular confidence in the chosen trustee).

**c. Perpetual Private "Purpose Trusts."** Finally, amended RSA 564-B:4-409 removes the time limit on "purpose trusts". These trusts are established for a purpose, not for the benefit of named beneficiaries, thereby denying any person standing to surcharge the trustee. Before TMCA, purpose trusts were limited to 21 years in duration. Now, however, purpose trusts may last indefinitely. This enables a settlor to create a purpose trust to hold a family business, or a "use" asset such as a family compound, in perpetuity without concerns about trustee liability for failure to diversify, or beneficiary lawsuits seeking to terminate or modify the trust. Only a named "trust enforcer" can enforce the purposes of the trust.

**3. Will the Courts Give Full Effect to These New Provisions?** The obvious intention of this legislation is to allow: (i) settlors to write their own scripts, directing retention of concentrated publicly-traded stock positions, family businesses, family lands or other assets without fear that their purposes will be disregarded by surcharge-loathing corporate trustees, results-oriented judges or beneficiaries with clever and persistent lawyers; (ii) trustees to administer modern OAT governance structures such as directed trusts, non-directed trusts with provisions that dilute or negate normal diversification principles, and "purpose trusts", and (iii) probate judges to expect less frivolous fiduciary surcharge litigation clogging their dockets based on alleged failures to diversify where the settlor or a proactive trustee, through informed counsel, has availed itself of any one or more of these new techniques.

But will the reality live up to the promise? New Hampshire's newly-minted legislation has not been battle-tested in the courts. The directed trust concept has, however, been litigated in other contexts that might provide some clues as to how a New Hampshire court might respond to any attempt to expand a directed trustee's responsibility and liability beyond that contemplated in the excluded fiduciary definition.

**a. Federal Courts: ERISA Directed Trust Litigation.** There have been some high profile cases decided under the Employment Retirement Income Security Act of 1974 ("ERISA") that address the duties of directed trustees of qualified plan assets to supervise, investigate and warn.

In *Tittle v. Enron Corp.*,[31] a Texas district court judge expanded the Second Restatement's "reason to suspect" standard, holding the Enron retirement plan's directed trustee to a "knew or should have known" standard. Northern Trust Company ("Northern") was the directed trustee of three Enron ERISA plans. A day after Enron announced a huge charge to its third quarter earnings, Northern imposed a "blackout period" on the purchase or sale of Enron's stock in its 401(k) plan pursuant to previous directions from Enron as plan sponsor to allow for a change in plan trustees from Northern to a successor. The inability to sell the Enron stock during the blackout period exacerbated the plan's participants' loss as Enron stock continued its freefall. The participants sued Northern (among others) for breach of fiduciary duty related to the blackout and for failure to diversify, alleging that the directed trustee Northern knew or should have known that the investment in Enron was imprudent.

Northern defended on the basis that it was a directed trustee and not a discretionary trustee. ERISA incorporates a directed trustee concept in its statute.[32] Relying heavily on the Restatement (Second), the court held that the directed trustee's duties survived despite the severe restrictions on the directed trustee's authority. The court concluded that it was a factual question whether the evidence presented was sufficient to give rise to a fiduciary duty on Northern's part to investigate the advisability of purchasing and retaining company stock.[33] Northern still retained a degree of discretion, authority and responsibility that might expose Northern to liability. A district court judge from the Southern District of New York found a similar obligation and potential liability exposure for a corporate directed trustee in WorldCom's ERISA litigation.[34]

### b. State Courts

**1. Virginia: *Rollins*.** Virginia has a statute explicitly relieving a directed trustee of fiduciary liability for following a direction.[35] A Virginia Circuit Court had the opportunity to interpret and apply that directed trustee statute in *Rollins v. Branch Banking and Trust Company of Virginia*.[36]

The trust in question contained a concentrated position in a publicly traded stock. The trust agreement provided that the settlor's children had full authority over "investment decisions as to the retention, sale or purchase of any asset of the Trust Fund."[37] The trustee obtained written authority from the beneficiaries to over-concentrate the trust. The trustee sold the stock 20 years later at the children's direction. The children sued for $25 million, claiming, inter alia, failure to diversify and failure to actively secure approval for the sale of the declining stock.

The Virginia court was apparently non-plussed by the statutory language purporting explicitly to relieve a directed trustee of fiduciary liability for following the direction. While the finding the trustee not liable for failure to diversify, the court stated that:

> [t]o insure the trust's conservation, a trustee also has a duty to keep informed as to the condition of the trust. Additionally, the trustee has a duty to impart to the beneficiaries any knowledge he may have affecting the beneficiary's interest and he cannot rid himself of this single "duty to warn".[38]

The court stated further that the "trustee has a duty to fully inform the beneficiaries of all facts relevant to the subject matter of the trust that come into the trustee's knowledge and which are material for the beneficiary to know for the protection of his interests."[39] In examining the statute, the court held that "the prohibition on recovery does not excuse a trustee from liability for failing to participate in the administration of the trust or failing to attempt to prevent a breach of trust. Thus, a trustee may be held liable for loss caused by his conduct for actions which he was entrusted to take. The demurrer is overruled as to ….the allegations of breach of fiduciary duty, except as they relate to failure to diversify."[40]

In Virginia, therefore, a directed trustee must remember what has been called the "duty to warn" – the fiduciary duty to keep the beneficiaries informed based on the trustee's knowledge even if the trustee does not have authority to act on that knowledge.

**2. Delaware: *Duemler*.** Rollins and the ERISA cases will most assuredly be cited by any plaintiff's attorney attempting to hold a New Hampshire directed trustee liable for investment losses despite the apparent clear intent of our legislature in creating the excluded fiduciary safe harbor. Trustees can take comfort, however, that a Delaware Chancery Court Judge has ruled in a directed trustee's favor in an unpublished ruling involving a Delaware statute that is strikingly similar New Hampshire's.[41]

In Duemler, the individual co-trustee and sole investment advisor of a trust sued the corporate trustee, alleging that the corporate trustee breached its fiduciary duty for failing to provide the investment advisor with appropriate financial information necessary for him to take actions on a bond that had defaulted and lost significant value. In his unpublished bench ruling, presiding Vice Chancellor Strine ruled in favor of the corporate trustee, finding that the Delaware directed trustee statute[42] required the investment advisor to make investment decisions without oversight from the trustee. The Vice Chancellor saw no reason not to apply the Delaware statute because there was "absolutely no evidence of willful misconduct" on the part of the corporate trustee, and to rule otherwise would undermine the statute.[43] (The court did find that the investment advisor had breached his fiduciary duties.)

**c. Clues from the New Hampshire Supreme Court.** It is impossible, of course, to determine the extent to which the courts in the ERISA and Rollins cases might have been influenced by the deep pocket theory, having been presented with aggrieved beneficiaries/plan participants with no recourse other than a corporate directed trustees' substantial coffers (or, more likely, their bonding company or liability insurer). Perhaps the courts found it difficult to swim upstream against the time-honored notion that being a "fiduciary" must mean that there is some duty to beneficiaries other than taking instructions without further inquiry. Any self-respecting litigator representing a beneficiary in a surcharge action for trust investment losses will be certain to join all trust participants as defendants – the investment director and the directed trustee alike. It is impossible to predict whether any given probate judge will accept plaintiffs' counsels' arguments that in the absence of any New Hampshire Supreme Court precedent interpreting the untested directed trust laws, Rollins and the ERISA cases should be followed, rather than trust counsel's assertion that Duemler is a superior analysis. However, counsel for the directed trustee can cite several New Hampshire cases to defend a client's cause.

**1. *Bartlett v. Dumaine*.**[44] This famous case was decided in 1986, prior to New Hampshire's enactment of the Uniform Trustees' Powers Act. At the time, the rigid and conservative "prudent conservator" default rule governed trustee investment decisions.[45] It involved an unusual trust structure that is perhaps an early example of the modern OAT.

> The plaintiffs were beneficiaries of one of the Frederic Dumaine trusts. They were well-funded and fully "lawyered-up", represented by White and Case, a well-known Wall Street firm. They challenged various trustee investments in closely-held corporations, the trustees' purported conflicts of interests in serving on boards of some of those corporations with which the trustees transacted unsecured loans of trust assets, upon terms and conditions that were not commercially reasonable, and the trustees' alleged "double dipping" by being compensated as both trustees and board members and executives of the affiliated corporations. The plaintiffs argued that such actions violated the trustees' core and non-waiveable duties of prudence and loyalty because the investments were speculative and the trustees were engaged in acts of self-dealing strictly prohibited under traditional trust principles.

In rejecting all of the plaintiffs' claims, the court found that it was the settlor's intent, although not explicitly stated, that the prudent conservator rule and the normal prohibition of self-dealing should not be applied to this particular form of "business trust". The opinion emphasizes that the trust was "[u]nique…having features of both a trust and a corporation," and that it was the "settlor's general intent" to give the trustees absolute control over the trust property and the trust business. Instead of the prevailing strict investment standard, the court applied a very forgiving "business judgment rule" to the challenged investment decisions and excused the self-dealing based on a finding that the settlor authorized the trustees "to take business risks with the trust funds."[46] Bartlett arguably stands for the proposition that the New Hampshire courts should be receptive to OAT structures that substantially alter traditional trustee responsibilities and potential surcharge liabilities, whether accomplished by statute or governing instrument.

### 2. Deference to the Legislature

**a. *Scheffel v. Krueger*.**[47] The New Hampshire Supreme Court is known for its judicial restraint and its sensitivity to the judiciary's limited role under the separation of powers doctrine. When confronted with a statute that is clear on its face, and a party's invitation to place a judicial "gloss" on unambiguous statutory language in order to achieve an avidly broader public policy, our court will often demur on the basis that "[it] is axiomatic that courts do not question the wisdom or expediency of a statute."[48] That was the case in Scheffel, where the court rejected the plaintiff's assertion that a "tort creditor" exemption should be engrafted on the two enumerated exemptions from spendthrift trust protection under RSA 564:23, II and III.[49] The justices restrained themselves, despite being confronted with an extremely sympathetic plaintiff (the mother of a minor victim of egregious sexual assaults at the hands of defendant who was the spendthrift trust's beneficiary), and the plaintiff's counsel's citation of precedent from other states in which more activist courts "judicially created spendthrift law."[50] Because the legislature had "[e]nacted a statute repudiating the public policy exemption sought by the plaintiff," the legislature's will could not be ignored. In holding for the bank trustee that asserted the spendthrift protection, the court cited both the clear language of the statutory spendthrift trust provision and the common law doctrine it overruled.[51]

**b. Hanke and Robbins.** In Hanke v. Hanke,[52] the justices refused the plaintiff's urging to change its then 38 year old "fraudulent transfer" test for determining whether the assets of a funded revocable trust were included in the "estate" against which the settlor's surviving spouse could make a statutory elective share claim.[53] The ruling

upholds the court's traditional standard, which it reaffirmed as the best "…attempt to reconcile the policy of permitting a spouse to freely dispose of his or her property with the policy of protecting a surviving spouse by guaranteeing him or her a portion of the deceased spouse's estate."[54] In the process, the court exalted two principles: freedom of disposition and stare decisis – the judicial doctrine courts invoke to avoid frustrating the legitimate expectations of attorneys and their clients that judges will not unsettle legal strategies permitted by long-standing precedent. The Hanke court concluded that "[i]f the legislature considers the [fraudulent transfer test] to be an improper balancing of these policies, it can [enact a statute rejecting it in favor of another] provision which it believes [achieves the proper balance]."[55]

*Robbins v. Johnson* upheld a probate judge's refusal to include the assets of a funded revocable trust in the probate estate to be shared by the testator's pretermitted children.[56] In so ruling, the court construed strictly the language of New Hampshire's pretermitted heir statute, which on its face applied to "wills" only, with no mention of trusts.[57] Robbins rejected the plaintiffs' urgings to extend to the statute on policy grounds, and the argument that a funded revocable trust is "testamentary in nature" that functions as a "will substitute."[58] The ruling is premised on the justices' "beli[ef] that the legislature should decide, as a matter of policy, whether it wishes to extend the pretermitted heir statute to will substitutes, such as the trust at issue…Absent clear indication from the legislature that this is its intention, we decline to apply the statute to the trust."[59]

These cases bode well for any future challenge to New Hampshire's recently-enacted (but judicially untested) trust statutes. Those statutes incorporate many rules and principles which are extremely clear in their language and application, but which in some cases embody new – some would say even radical – legislative policy determinations. While certain elements of this new trust code might be rejected by an activist appellate judge in another state as a declaration of bad public policy, or inconsistent with traditional fiduciary concepts, such a result is inconceivable to any seasoned observer of a judiciary with a two hundred-year tradition of judicial restraint and deference to the legislature's prerogatives.

## E. DRAFTING AND OTHER OPPORTUNITIES

Open architecture trust designs provide a variety of drafting and other opportunities to trust settlors and beneficiaries, as well as to fiduciaries and counsel for the various parties.

### 1. OAT Settlors

Can now fine-tune trust structures to "unbundle" traditional trust duties, allocating them to the parties who are most capable of handling them.

Where appropriate, can enable beneficiaries to participate in trust investment and distribution decisions, creating the opportunity for financial literacy and economic stewardship training, with maximum "buy-in."

For large financial families, can fully integrate trust management with administration and control of non-trust assets (whether under auspices of family office or otherwise).

Assured that traditional non-trust quality special assets, including

concentrated public equity positions, closely-held business interests and "heirloom" real estate, can be held in perpetuity in trust without threat of sale to avoid surcharge liability.

### 2. OAT Beneficiaries

Offers potential for taking active and more meaningful role in trust administration, creating opportunities for stewardship and financial literacy training, and better understanding of the purposes and benefits of the trust structure as part of family's strategic plan for dynamic wealth preservation.

No longer indentured to unitary corporate trustees that might be unresponsive, expensive and lack special asset class management capabilities.

### 3. Professional Fiduciaries

Can use excluded fiduciary concept as layer of insulation against risk of surcharge, particularly relating to investment diversification requirement.

Can retain responsibility for trustee functions with respect to which it possesses core competencies (trust administration and "core stock" and fixed income management), while other participants handle more exotic, non-traditional trustee functions (special assets, alternative investments, trust distributions, etc.) where the potential for fiduciary liabilities has historically been greatest.

Have opportunity to build alternative business model for OATs, involving directed/administrative trustee services priced fairly to create reasonable profit margin and reflect lower levels of risk and responsibility.

### 4. Estate Planning Attorneys

Can craft OATs to meet financial families' often idiosyncratic objectives concerning investment management, beneficiary participation, etc.

Can serve as local counsel for migrating inbound trusts that must be retrofitted through judicial or non-judicial trust modification to become New Hampshire resident trusts to achieve family's objectives (e.g., refuge from other states' income taxes, adoption of OAT features that might not be available under the laws of the former situs state, etc.).

Have opportunity to serve as directed trustee, protector or advisor with risks and responsibilities tailored to fit the desires and objectives of both family and the attorney.

## CONCLUSION

Trust law is evolving in the United States, and New Hampshire has enacted some of the most progressive trust laws in the country. Part of this progression includes the development of open architecture techniques for trust governance. Careful and thoughtful use of OAT structures will provide new opportunities that will empower families and provide comfort to fiduciaries.

## ENDNOTES

1. Silverman, *How Many Trustees Do You Need?*, Wall Street J., July 12, 2007, at B5.

2. *Id.*

3. *See, e.g.,* King and McDowell, *Delegated vs. Directed Trusts*, 145 Tr. & Est. 26 (July 2006); Bove, *Trust Protectors*, 144 Tr. & Est. 28 (Nov. 2005); Minnigh, *Using Trust Protectors in Domestic Estate Planning*, 48 Tax Mgmt. Memo. 3 (Jan. 8, 2007); Lahey, *Open-Architecture Trusts: The Wiser Choice*, 142 Tr. & Est. 44 (Aug. 2003).

4. The New Hampshire UTC is codified at RSA 564-B.

5. *See generally*, Sarafa and Duncan, *The Coordination Gap: Ordering Relationships Among Trustees, Co-Trustees, Protectors, Advisors and Other Trust Participants*, 33rd Annual Notre Dame Tax and Estate Planning Institute (2007).

6. For a thorough treatment of the evolution of Anglo-American of trust law, *see* Curtis, *The Transmogrification of the American Trust*, 31 Real Prop., Prob. and Tr. J. 251, 256 (Summer 1996).

7. Restatement (Second) of Trusts §185 (1992), comment c (the "Restatement (Second)").

8. *Id.*

9. *See, e.g.,* Restatement (Second) §184, Comment c.

10. Restatement (Third) of Trusts §39 (2003) (the "Restatement (Third)").

11. *See, e.g., Stuart v. Continental Illinois National Bank Trust Co. of Chicago*, 369 N.E. 2d. 1262 (1977).

12. Restatement (Second) §184, comment c.

13. *See Klein v. Reed,* 479 N.E. 2d. 714 (Mass. App. Ct. 1985).

14. Restatement (Second) §184, comment c.

15. Bogert, *The Law of Trusts and Trustees*, §701 (2d Rev. ed. 1984).

16. Restatement (Second) §224.

17. Comments to the Restatement (Third) state that the rule of majority trustee action which now prevails in most states ordinarily protects a dissenting trustee from liability for an act authorized by the majority, while preserving the dissenting trustee's duty normally to participate in deliberations and decision making and to act reasonably to prevent a breach.

18. Trust quality investments traditionally included a diversified portfolio of large capitalization growth stocks, laddered portfolio of intermediate term treasury bonds and/or investment-grade municipal bonds, and cash held in an insured money market account.

19. Bogert , *supra* note 15, §612, n. 20.

20. For example, a corporate trustee lacking expertise in a certain investment area such as venture capital or foreign investing may delegate that particular responsibility. *Id.*

21. *See* Adams, *Trustees Delegating Investments*, 142 Tr. & Est. 80 (June 2003).

22. *See generally* Restatement (Second) §185 (1959) (cases cited therein, and comments c and e.).

23. *See* comment to §808 of the Model UTC (indicating that §808(b) relating to directed trustees "imposed only minimal oversight responsibility on the [directed] trustee. A trustee must generally act in accordance with the direction …refusing only if the attempted exercise would be manifestly contrary with the terms of the trust or the trustee knows the attempted exercise would constitute a serious breach of a fiduciary duty owed by the holder of the power to the beneficiaries of the trust.")

24. The comments to Article 8 of the UTC differentiate a trust protector from conventional advisors, stating: "[a]dvisors" 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.

25. "Market" or "systemic" risk is risk that is common to all securities of the same general class. A trustee cannot reduce this risk through diversification.

26. *See, e.g., Bartlett v. Dumaine*, 128 N.H. 497, 507-08 (1986) (trust settlor may choose to apply more liberal and forgiving "business judgment rule" to trustee's investments in lieu of "prudent conservator" rule then prevailing under New Hampshire common law); *In re Frolich's Estate*, 112 N.H. 320, 327 (1972) "…a person's right to dispose of property by…trust in such manner and by such means as he sees fit includes the right to increase or decrease those burdens which are ordinarily imposed upon fiduciaries…, including the duty of loyalty").

27. *See, e.g., In re Will of Dumont*, 809 N.Y.S. 2d 360 (App. Div. 2006), *rev'g* 791 N.Y.S. 2d 868 *(*2004); *Wood v. U.S. Bank, N.A.,* 828 N.E. 2d 1072 *(Ohio App. 3d 2005).*

28. *See generally* Cline, *Do Trustees Have An Absolute Duty to Diversify?* 31 Tax Mgmt. Est., Gifts & Tr. J. 140 (2006).

29. Of course, a trustee who fails to diversify and who cannot rely on a provision on the governing instrument or a court order is likely to be surcharged for any resulting losses if the trustees' failure to diversify is deemed to be unreasonable under the general prudent investor standards of §9-901 and the specific "special circumstances" exception of §9-903,

with all of their resulting uncertainty. Anyone considering a trusteeship which will require the retention of concentrated positions or special assets will be well advised to insist that specific authority or direction be given in the trust agreement, or, if the trust agreement is irrevocable and does not provide it, seek a modification through a nonjudicial settlement agreement, where available, or court-order to include such a direction or authorization.

30. The 2008 amendments to the UTC eliminate any distinction between a trust advisor and trust protector.

31. 284 F.Supp. 2d. 511 (S.D. Texas 2003).

32. *See* §403(a)(2) of ERISA.

33. 284 F.Supp. 2d at 601.

34. *In re WorldCom, Inc. ERISA Litigation*, 263 F. Supp. 2d. 745(S.D. N.Y. 2003).

35. Va. Code §26-52 ("Whenever the instrument under which a fiduciary or fiduciaries are acting reserves unto the trustee, testator or creator or vests in an advisory or investment committee or any other person or persons, including a co-fiduciary to the exclusion of one or more of the fiduciaries, authority to direct the making or retention of investments, or any investment, the excluded fiduciary or co-fiduciary shall be liable, if at all, only as a ministerial agent and shall not be liable as a fiduciary or co-fiduciary for any loss resulting from the making or retention of any investment pursuant to such authorized direction.")

36. 56 Va. Cir. 147 (Virginia Circuit Court 2002).

37. *Id.*

38. *Id.*

39. *Id.*

40. *Id.*

41. C.A. No. 20033 V.C. Strine (Del. Ch. 2004), *cited in* Gordon, *Directed Trusts: The Use of Trust Advisors and Protectors: Can Fiduciaries Limit Liability Through Directed Trusts? Empowering Trust Protectors While Minimizing Their Liability, or Can A House Divided Long Stand?* Notre Dame Tax Estate Planning Institute §18-8 (2006).

42. 12 Del. C. §3313(d).

43. Gordon, *supra* note 41, at §18-9.

44. 128 N.H. 497, 523 A.2d 1 (1986).

45. *See generally* DeGrandpre, *Wills, Gifts & Trusts*, 7 New Hampshire Practice §63-8.

46. 128 N.H. at 507-08.

47. 146 N.H. 669, 782 A.2d 410 (2001).

48. *Brahmey v. Rollins*, 87 N.H. 290, 179 A. 186 (1935).

49. 146 N.H. at 671.

50. *Id.*, *citing Sligh v. First Nat. Bank of Holmes County,* 704 So. 2d. 1020, 1024 (Miss. 1997); *Elec. Workers v. IBEW-NACA Holiday Trust,* 583 S.W. 2d 154, 162 (Mo. 1979).

51. *Id.*

52. 123 N.H. 175, 459 A. 2d 246 (1983).

53. *Id.* at 178, 248.

54. *Id.*

55. *Id.* at 179-80, 248. Compare the judicial restraint demonstrated in *Hanke* to the activism of the Supreme Judicial Court of Massachusetts ("SJC") in *Sullivan v. Burkin*, 390 Mass. 864, 460 N.E. 2d 571 (1984). In *Sullivan*, the SJC prospectively overruled a 39 year old case that had interpreted the corresponding Massachusetts statute as excluding from the elective share "estate" the assets of a deceased spouse's funded revocable trust. The SJC cited "…significant changes since 1945 in ***public policy considerations*** bearing on the right of one spouse to treat his or her property as he or she wishes during marriage…" in finding that it is "…neither equitable nor logical to extend to a divorced spouse greater rights in the assets of an *inter vivos* trust created and controlled by the other spouse than are extended to a spouse who remains married until the death of his or her spouse." *Id.* at 869, 576 (emphasis supplied).

56. *Robbins v. Johnson*, 147 N.H. 44, 780 A. 2d 1282 (2001).

57. *Id.* at 46, 1284.

58. *Id.*

59. *Id.*