

# Michigan's Proposed Adoption of the UNIFORM DIRECTED TRUST ACT

By James P. Spica

On November 11, 2017, the State Bar of Michigan Probate and Estate Planning Section Council approved a legislative proposal developed by its Divided & Directed Trusteeships Ad Hoc Committee.<sup>1</sup> The proposal introduces two innovations to the Michigan Trust Code (MTC): it imports a version of the Uniform Directed Trust Act (UDTA), which regulates what are commonly known as powers to direct trustees,<sup>2</sup> and it provides a statutory template for a more radical scheme of fiduciary coordination that may be styled *divided trusteeship*.<sup>3</sup> The author has written extensively elsewhere about divided trusteeships.<sup>4</sup> This article focuses on the proposal's version of the UDTA.<sup>5</sup>

Michigan's adoption of the proposal will change the treatment of powers to direct trustees of express trusts<sup>6</sup> by changing the scope of the MTC's imposition of ineradicable duties on the holders of such powers and by changing the circumstances in which a trustee subject to such a power can be liable for doing as the powerholder directs or for doing nothing (if that is what the trust instrument creating the power contemplates) when directions from the powerholder are not forthcoming. The first of these changes will enable certain common estate planning techniques that the MTC currently rules out and will facilitate other techniques that the MTC currently makes unnecessarily risky and laborious. The second change will support market incentives for price differentiation among professional trust-service providers by allowing settlors to waive a directed trustee's obligation to second-guess powerholders.

## Scope of imposition of duties to trust beneficiaries on holders of powers to direct

The proposal's importation of the UDTA is effected primarily by the addition of § 7703a of 2018 HB 6130,<sup>7</sup> which displaces existing MCL 700.7809.<sup>8</sup> This substitution alters the scope of

the MTC's imposition of ineradicable duties on the holders of powers to direct in two ways: (1) there are powers currently triggering mandatory obligations to trust beneficiaries under section 7809 that will *not* trigger obligations under section 7703a (newly excluded powers) and (2) there are powers that will trigger mandatory obligations to trust beneficiaries under section 7703a that do *not* trigger obligations under section 7809 (newly included powers). There are also, of course, powers currently triggering mandatory obligations to trust beneficiaries under section 7809 that will also trigger obligations under section 7703a (overlap powers).

## Overlap powers

Overlap powers include powers in nonsettlor-nonbeneficiaries to direct trust investments, vote proxies for trustee-owned securities, make or take loans, adopt (or determine the frequency or methodology of) valuations, manage (or select managers for) trust-owned businesses, select a custodian for trust assets, direct the delegation of trustee powers, change the trust's principal place of administration or the law governing the meaning and effect of the trust's terms, determine the compensation to be paid to a trustee, veto a trustee's exercise of specified powers, or release a trustee from liability for an action proposed or previously taken by the trustee.<sup>9</sup>

## Newly excluded powers

Two important examples of newly excluded powers are a power decisively to ascertain the happening of an event that affects the administration of a trust when the powerholder is a



healthcare professional acting in that capacity in exercising the power,<sup>10</sup> and an expressly nonfiduciary power that “must be held in a nonfiduciary capacity to achieve the settlor’s tax objectives under the Internal Revenue Code.”<sup>11</sup> Currently, a power of either kind draws the imposition under MCL 700.7809 of ineradicable duties to trust beneficiaries if the powerholder is neither a settlor nor a beneficiary of the trust in question and the power does not constitute a power of appointment.<sup>12</sup>

Those ineradicable duties to beneficiaries are liable to frustrate intentional planning if, for example, the terms of the trust grant a nonbeneficiary consulting physician (who is at all likely to consult counsel before acting) a power to certify that the trustee has, at some point, become “disabled,” whereupon a majority of the then-current income beneficiaries of the trust will be entitled to elect a successor trustee.<sup>13</sup> Likewise, ineradicable duties to trust beneficiaries are liable to frustrate tax planning if a nominally nonfiduciary administrative power described in IRC 675(4) is granted to someone other than the settlor or a beneficiary of the trust to trigger so-called “grantor trust” status.<sup>14</sup>

### Newly included powers

Two important examples of newly included powers are overlap powers held by settlors of irrevocable trusts<sup>15</sup> and powers of appointment that are either presumptively administrative (e.g., a power to adjust between principal and income for fiduciary accounting purposes) or expressly fiduciary (i.e., designated as fiduciary powers by the terms of the trust).<sup>16</sup> Whereas MCL 700.7809 has nothing to say about settlors who have powers to direct or nontrustees who have powers of appointment,<sup>17</sup> the proposal extends a convenient default regime of fiduciary coordination<sup>18</sup> to both of these newly included powers and, in doing so, provides default protection from untoward tax consequences.<sup>19</sup>

What is at least as important, though, is that by presumptively regulating these newly included powers, the proposal permits settlors decisively to relieve trustees who are subject to such powers of potential liability for failing to second-guess powerholders. This is because (as mentioned previously) in addition to changing the scope of the MTC’s imposition of ineradicable duties on the holders of powers to direct, the proposal changes the circumstances in which a trustee subject to direction can be liable for doing as the powerholder directs.

### Circumstances in which a trustee subject to direction can be liable for doing as the powerholder directs

Under MCL 700.7809, a trustee acts at his or her own peril in following a trust protector’s direction (i.e., in complying with the exercise or nonexercise of a trust protector’s power to direct) if the direction “constitute[s] a breach of a fiduciary duty that *the trust protector* owes to the trust beneficiaries,”<sup>20</sup> and the trustee arguably cannot be protected from that peril by the terms of the trust.<sup>21</sup> But a trustee subject to the default rules of the proposal’s version of the UDTA acts at his or her own peril in following a direction (when the powerholder is acting within his or her authority under the trust instrument) only if the direction was obtained *with the directed trustee’s collusion or by the directed trustee’s fraud*.<sup>22</sup>

By allowing the settlor to relieve a trustee who is subject to direction of any obligation to second-guess the holder of a power to direct (as long as the powerholder is acting within his or her authority under the terms of the trust), the proposal allows trustees to take the settlor’s division of administrative labor (as expressed in the terms of the trust) seriously as an allocation of fiduciary risk. This is important because professional trust-service providers are increasingly being asked by settlors to reduce their standard fees in light of allocations of administrative responsibilities to holders of powers to direct. The settlor reasons that the powerholder will assume responsibility for the directed function and that because an undertaking to follow directions is less onerous than an undertaking to decide what to do and then execute all on one’s own initiative, the directed professional trustee’s standard fee should be adjusted.

But *is* undertaking to follow directions less onerous than undertaking to decide what to do and do it? The professional trustee will evaluate whether to cut his or her standard fee in this situation by asking in what circumstances the trustee can be liable for doing what the settlor would have him or her do—namely, follow directions. To the extent that following a powerholder’s directions (when the powerholder is acting within his or her authority) effectively insulates the trustee from liability, the trustee can take the settlor’s division of administrative labor seriously as a scheme of fiduciary-risk allocation. But to the extent the trustee can be liable to trust beneficiaries for doing exactly as directed (when the holder of

### AT A GLANCE

- Adoption of the Uniform Directed Trust Act (UDTA) in Michigan will enable certain common estate planning techniques that the Michigan Trust Code (MTC) currently rules out and will facilitate other techniques that the MTC currently makes unnecessarily risky and laborious.
- By allowing settlors to waive a directed trustee’s obligation to second-guess trust directors, the proposed version of the UDTA will allow trustees to take the settlor’s division of administrative labor seriously as an allocation of fiduciary risk and thereby support market incentives for price differentiation among professional trust-service providers.

the power to direct is acting within his or her authority), the request that the trustee reduce his or her professional fee is a request that the trustee forgo compensation for the attendant risk of liability or (equivalently) for effort that the trustee will have to mount—in the way of vigilance over the powerholder—to avoid such liability.

## Conclusion

By requiring trustees who are subject to direction to second-guess the holders of powers to direct *regardless* of what the terms of the trust say,<sup>23</sup> the MTC currently forces professional trustees to discount settlors' divisions of fiduciary labor as schemes of fiduciary-risk allocation and thereby frustrates real market incentives for price differentiation. The proposal's version of the UDTA will allow those market incentives to operate by letting settlors waive a directed trustee's obligation to supervise powerholders. ■

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## ENDNOTES

- As of this writing, the proposal is embodied in three bills introduced in the Michigan House of Representatives: 2018 HB 6129, 2018 HB 6130, and 2018 HB 6131.
- See, e.g., Restatement of Trusts, 3rd (2003), § 75 (regarding "a power to direct or otherwise control certain conduct of the trustee"); Unif Trust Code § 808(b) (Unif Law Comm'n 2010) ("power to direct certain actions of the trustee"); MCL 700.7103(n) ("the power to direct certain actions with respect to the trust").
- "While a separate trustees provision applies, the whole trusteeship of the aggregate trust is *divided*, under the terms of the separate trustees provision, into discrete sets of separately accepted fiduciary responsibilities." 2018 HB 6129, § 7703b(2) (emphasis added).
- Spica, *Onus Fiducia Est Omnis Divisa in Partes Tres: A Statutory Proposal for Partitioning Trusteeship*, 49 Real Prop Tr & Est LJ 349 (2014). It should be noted that the statutory proposal that appears in the 2014 article at pp 371–378 differs in some respects from the proposal's divided trusteeship provisions (2018 HB 6129, § 7703b). For one thing, the proposal is more *laissez faire* (in the sense described at pp 378–379 of the 2014 article) than the 2014 article's statutory model.
- The proposal's version of the UDTA differs substantively from the uniform act in some respects. Under the proposal, for example, a directed trustee may be liable for complying with the exercise or nonexercise of a power of direction only "if the exercise or nonexercise was obtained with the directed trustee's collusion or by the directed trustee's fraud and compliance would be in pursuance of that collusion or fraud." 2018 HB 6130, § 7703a(7). Under the uniform act, on the other hand, a directed trustee may be liable for complying with the exercise or nonexercise of a power of direction "to the extent that by complying the trustee would engage in willful misconduct." UDTA § 9(b) (Unif Law Comm'n 2017).
- An express trust is a trust intentionally created by the exercise of powers implicit in ownership of property, as opposed to a constructive trust or a resulting trust, which is created by operation of law. See MCL 700.1107(n) (excluding constructive trusts and resulting trusts from denotation of "trust" for purposes of the Estates and Protected Individuals Code, of which the MTC is part); Gardner, *An Introduction to the Law of Trusts*, 3rd Ed. (Oxford University Press, 2011), pp 4–5; and Penner, *The Law of Trusts*, 8th Ed (Oxford University Press, 2012), §§ 2.2–2.8.
- 2018 HB 6130, § 7703a comprises the bulk of the UDTA, but because the uniform act was promulgated by the Uniform Law Commission as a standalone statute (see UDTA § 1) whereas the proposal ensconces its version of the UDTA within the MTC, the proposal places some of the uniform act's structural provisions in natural places within the MTC that fall outside the new section. Thus, for example, the UDTA provision that allows a settlor to extend the act's application to the relations of co-trustees *inter se* is located, under the proposal, in the MTC provision on co-trusteeships. See 2018 HB 6131, § 7703(10) (UDTA § 12).
- 2018 HB 6131 enacting § 1 (repealing MCL 700.7809). The MTC is a version of the Uniform Trust Code (UTC), and the effect of adoption of the UDTA in a state that has adopted the UTC, is to displace subsections (b) through (d) of UTC § 808 (see UDTA § 9, legislative note), which have their local installation in Michigan in MCL 700.7809. Cf. Unif Trust Code § 808(b)–(d).
- The illustrations in the text are drawn from UDTA § 6, comment a.
- 2018 HB 6130, § 7703a(6) (UDTA § 8(b)–(c)).
- 2018 HB 6130, § 7703a(1)(f) (UDTA § 5(b)(5)).
- MCL 700.7103(n) (excluding settlors and nontrustee holders of powers of appointment from denotation of "trust protector" for purposes of MTC) and MCL 700.7809(1) (imposing minimum obligations to trust beneficiaries on "[a] trust protector[] other than a trust protector who is a beneficiary of the trust" (emphasis added)). See also MCL 700.7105(2)(h) (minimum obligations imposed on trust protectors by MCL 700.7809 not liable to be subverted by terms of the trust).
- UDTA § 8, comment b.
- IRC 675(4) and 26 CFR 1.675-1(b)(4)(iii) (specifying the sense in which a power must be "nonfiduciary" to trigger the relevant federal income tax status). See also UDTA § 5, comment 5.
- 2018 HB 6130, § 7703a(24)(f)(iii) (UDTA § 2(9)).
- 2018 HB 6130, § 7703a(24)(e) (UDTA § 2(5)) (defining "power of direction"), 2018 HB 6130, § 7703a(1)(a) (UDTA § 5(b)(1)) (excluding powers of appointment intended to be held by donee in nonfiduciary capacity from extension of "power of direction"), and 2018 HB 6130, § 7703a(2)(b) (UDTA § 5(c)) (certain powers of appointment granted to a donee other than a trustee constructively presumed to be nonfiduciary powers).
- MCL 700.7103(n).
- Involving, for example, rules of construction (see 2018 HB 6130, § 7703a(2)–(3) (UDTA § 5(c), 6(a)), rights to information (see 2018 HB 6130, § 7703a(9)–(10) (UDTA § 10)), and procedural protections (see 2018 HB 6130, § 7703a(17)–(19) (UDTA § 13–14)).
- As to the federal estate and gift tax consequences of a fiduciary power to adjust between principal and income, for example, see 26 CFR 20.2041-1(b)(1) and 26 CFR 25.2514-1(b)(1).
- MCL 700.7809(4)(b) (emphasis added).
- MCL 700.7801 (specifying modes in which trustee must administer trust), MCL 700.7908(1)(a) (limiting exculpation of trustee), and MCL 700.7105(2)(b) and (k) (duties imposed by MCL 700.7801 and limitations imposed by MCL 700.7908 not liable to be subverted by terms of the trust). See also UDTA § 9, legislative note.
- 2018 HB 6130, §§ 7703a(2)(a) and 7703a(7) (emphasis added).
- MCL 700.7809(4)(b) (trustee's duty to second-guess trust protectors), MCL 700.7801 (specifying minimum duties of trustee), MCL 700.7908(1)(a) (limiting exculpation of trustee), and MCL 700.7105(2)(b) and (k) (duties and limitations imposed by MCL 700.7801 and MCL 700.7908 not liable to be subverted by terms of the trust). See also UDTA § 9, legislative note.