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Directed Trusts—Jewel Inside the UTC
by Glenn A. Henkel

On Jan. 19, 2016, Governor Chris Christie signed A-2915/S-2035, known as the Uniform Trust Code (UTC) as Chapter 276, P. L. 2015. This large work includes 82 provisions and results in a codification of the New Jersey trust rules. In New Jersey, trust law has been developed over 150 years and, thus, the *need* for a trust code in New Jersey was not as prevalent as other jurisdictions. In some states, there are only a few trust cases ever decided, and the UTC was commissioned to add rules where none existed. In New Jersey, the population has been making, challenging and litigating various issues related to trusts for a long time and, as such, the case law is extensive. However, this new code will put everything in one place.

The UTC was created as a project of an *ad hoc* committee of trust and estates lawyers in the New Jersey State Bar Association (NJSBA) who attempted to conform the New Jersey UTC in compliance with New Jersey's common law. This article is not about the trust code, per se, but instead about a provision added to the trust code involving the concept of a 'directed trust.'

The NJ-UTC was a product of the NJSBA, principally the Real Property, Trust and Estate Law Section. In order to obtain political support within the Legislature for the provisions, the NJSBA reached out to the New Jersey Banker's Association for its support. The bankers' lobbyists turned to their constituency to see whether the bankers should support this project or not. Typically, in other states (the UTC has been enacted in about 30 other states), bankers were significant allies in enactment. In New Jersey, the bankers requested that the bar make the trust law "more like Delaware."

Like the corporate arena, Delaware trust law has always been viewed as progressive and 'pro management.' The *ad hoc* committee considered this request and focused on two particular aspects to Delaware law that could have been considered—qualified domestic trusts (QDTs) and directed trusts.

While beyond the scope of this article, the QDT did not seem consistent with New Jersey law. It seeks to allow 'self-settled' trusts to escape the reach of creditors, contrary to N.J.S.A. 3B: 11-1.

By contrast, the second provision of the Delaware law was particularly appropriate for New Jersey. Many states are enacting directed trusts statutes. If a settlor created a trust to provide for specific terms to bifurcate responsibility for a particular asset between two 'fiduciaries,' New Jersey law has always followed the 'probable intent' of the testator. This was such well-settled case law that it was codified in 2004.[1] Since 1986, Delaware has had a statute that gave the trustee (usually a corporate trustee) the ability to take direction from another individual serving as an investment advisor. Typically, this will allow for a lower fee for a trust that holds a 'difficult' asset, such as a residence or business. This, it was felt, would be an appropriate mechanism for New Jersey law because of the probable intent doctrine.

The bankers agreed to support the UTC assuming the NJSBA would support the directed trust statute. Thus, with the UTC, the state now also has a directed trust provision to be codified in N.J.S.A. 3B: 31-61 and N.J.S.A. 3B:31-62. The directed trust statute now gives greater authority to New Jersey clients to include provisions that authorize a trustee to direct investment functions to another individual.

The UTC already included a provision that authorized direction. This provision is now codified in N.J.S.A. 3B:31-61 (effective July 17, 2016), whereby a trust can confer upon another trustee the ability to let a trustee follow the direction of a third party. This power under N.J.S.A. 3B:31-61(c) can be as broad as the power to direct the modification or termination of the trust. However, the bill annexed an additional provision called "Powers to Direct Investment Functions," which is very similar to the Delaware directed trust statute contained in 12 Del. Code §3313.[2]

This new statute has an operative provision authorizing a trustee to be obligated to follow a third-party investment advisor "direction" or "consent." Such an 'investment advisor' is a fiduciary, meaning he or she will have typical fiduciary roles. Moreover, the statute goes on to provide that the trustee would not be liable for acts except in the cases of "willful misconduct or gross negligence on the part of the fiduciary so directed." The gross negligence standard is broader than the Delaware statute, and it appears to be very advantageous to a trustee. Moreover, absent clear and convincing evidence, the directed trustee is not responsible for taking administrative steps to review the activities of the investment advisor and the directed trustee has no duty to monitor the conduct of the investment advisor or provide advice to the investment advisor or communicate or apprise beneficiaries with the directed investment.

Why would a directed trust provision be helpful? In some circumstances, when an individual utilizes a corporate fiduciary, there could be a concern on the part of the corporate fiduciary to the underlying assets that are particular to the family. Often, a family business or vacation residence will constitute a part of the *corpus* of the trust. By having a third-party investment advisor responsible for this particular asset, a corporate fiduciary can accept a trusteeship without the obligation to diversify. Several cases outside New Jersey in recent decades have dealt with a circumstance where the trustee was told to maintain a particular investment (such as stock in Eastman Kodak Company) and, because of the direction, the trustee did not pay attention to the decline in value.[3] Upon subsequent suit for damages by beneficiaries, the courts (again, outside New Jersey) held that a trustee was responsible for the circumstance. With a directed trust statute, a third-party investment advisor can be told to monitor the particular investment, thereby allowing the corporate fiduciary to be free from the burden of this particular asset.

If an investment advisor is named in a document as an investment advisor, be wary that the individual will continue to have fiduciary duties as related to that investment. This can be problematic if the investment is a business interest or vacation home. However, typically, the individual serving as an investment advisor will be closer to the family and will be aware of the goals and objectives of the family maintaining that asset. As a fiduciary, the investment advisor will be entitled to commissions and fees. Moreover, the use of an investment advisor in a trust does not preclude a settlor from granting an individual a 'non-fiduciary' power.

In sum, the author believes the enactment of the New Jersey directed trust statute in N.J.S.A. 3B: 31-62 is a welcome addition to New Jersey trust law. For those critics of the provision who feel it can produce to a bad result, simply draft away from its use.

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Endnotes

1. *See* N.J.S.A. 3B:3-33.1; *See also, Fidelity Union Trust Company v. Robert,* 36 N.J. 561 (1962); *Engle v. Siegel* 74 N.J. 287 (1977); *in Re Estate of Branigan,* 129 N.J. 324 (1992).
2. *See* N.J.S.A. 3B:31-62.
3. *See generally* the seminal case of *Matter of Janes,* 90 NY2d 41, 659 NYS 2nd 165 (1997), *reargument denied*, 90 NY2d 885, 661 NYS 2d 827 (1997); *See also Matter of Hunter,* 2010 NY Slip Op. 50548(U)[27 Misc 3d 1205(A)].