

Utilizing Delaware's Excluded Co-Trustee Statute, Section 3313A of Title 12 of the Delaware Code

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Enacted in 2017, Section 3313A of Title 12 of the Delaware Code (Delaware's "Excluded Co-Trustee Statute") addresses the duties and liabilities of co-trustees wherein the trust instrument confers on a co-trustee or co-trustees the exclusive power to take, or direct another trustee to take, specified actions with respect to the trust. In this article, the trustee who is granted an exclusive power over a trust is known as the "non-excluded trustee" with respect to that power, and each other trustee is known as an "excluded trustee". The Excluded Co-Trustee Statute codifies the concept of reducing or completely eliminating the liability of a co-trustee for matters entirely outside of the scope of its authority pursuant to the provisions of a trust instrument. This article examines the terms of the Excluded Co-Trustee Statute, some of its practical uses, and some of the issues that practitioners should be aware of when trustee powers are bifurcated among co-trustees.

The Excluded Co-Trustee Statute is modeled after Section 3313 of Title 12 (Delaware's "Directed Trust Statute"), but goes further to address the complete bifurcation of the trustees' powers and responsibilities among co-trustees. In a traditional directed trust, the trustee retains its powers, but the trust instrument vests the discretion for decisions regarding one or more of the trustee's powers in other individuals or entities referred to as "advisers" under the Directed Trust Statute. The discretion vested in an adviser can relate to a variety of different types of decisions, including investment decisions, distribution decisions, and administrative decisions related to the trust, and the trustee is required to carry out such decisions upon the direction of the appropriate adviser.



An excluded trustee arrangement bifurcates the trustees' powers and responsibilities between the trustees themselves. The trust instrument can expressly confer upon the non-excluded trustee either the power to direct the excluded trustee to take or refrain from taking certain actions, or the exclusive authority to exercise certain trustee powers without the involvement of the excluded trustee. Pursuant to Section (a)(1) of the Excluded Co-Trustee Statute, if the terms of the trust instrument confer the power to direct certain actions of the excluded trustee on the non-excluded trustee, the excluded trustee has no duty to act in the absence of such direction and is not liable, individually or as a fiduciary, for any loss resulting from compliance with the direction absent wilful misconduct on the part of the excluded trustee. This is the same standard of liability applied to a directed trustee acting in compliance with a direction given by an adviser under the Directed Trust Statute. In contrast, an excluded trustee is not liable, even for wilful misconduct, for any loss resulting from an action taken by the non-excluded trustee in the exercise of a power exclusively granted to a non-excluded trustee under the trust instrument.

Section (a)(2) of the Excluded Co-Trustee Statute provides that, if the terms of the trust instrument confer on a non-excluded trustee exclusive authority to exercise any power, the excluded trustee is not liable, individually or as a fiduciary, for any loss resulting directly or indirectly from the action taken by the non-excluded trustee in the exercise of the power. In 2018, Section (a)(2) was amended to expressly clarify that the excluded trustee is not even considered a fiduciary with respect to any power conferred

exclusively upon the non-excluded trustee, but is a fiduciary with respect to any power not exclusively conferred upon the non-excluded trustee. In this regard, Section (a)(2) is a significant expansion of the limited liability concept applicable to directed trustees, embodied by the Directed Trust Statute. Not only is the excluded trustee expressly shielded from liability for any loss resulting from the exercise of powers solely conferred on a non-excluded trustee, the excluded trustee is not even a fiduciary with respect to those powers. Section (b) of the Excluded Co-Trustee Statute further provides that the non-excluded trustee holding an exclusive power shall be liable to the beneficiaries with respect to the exercise of that power, as if the excluded trustee were not in office, and only the non-excluded trustee has the obligation to account to the beneficiaries and defend any action brought by the beneficiaries with respect to the exercise of the exclusive power. In short, under Delaware law, an excluded trustee has no duties, and also no liability, with respect to any power conferred exclusively on a non-excluded trustee.

Similar to a directed trust arrangement, an excluded trustee has no duty to monitor the conduct of, provide advice to, consult with, or request directions from the non-excluded trustee, pursuant to Section (a)(3) of the Excluded Co-Trustee Statute. Furthermore, an excluded trustee is not required to give notice to any beneficiary of any action taken by a non-excluded trustee, whether or not the excluded trustee agrees with the result.

In practice, the close similarities between a directed trustee arrangement under the Directed Trust Statute and an excluded

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co-trustee arrangement under the Excluded Co-Trustee Statute often raises the following question: When should one design be used over the other? Having two years to contemplate that question since the enactment of the Excluded Co-Trustee statute has led to some interesting answers.

For example, consider a scenario in which an adviser directs a trustee of a directed trust to execute a federal income tax return that is prepared by an accountant unfamiliar to the trustee, or on which an aggressive filing position is taken over the trustee's objection. Under the Directed Trust Statute, the directed trustee will only be liable for wilful misconduct when complying with the direction. However, the directed trustee executes the return under penalties of perjury, and under federal law a trustee can be subject to personal liability for the trust's unpaid income taxes and tax-related penalties. The interaction between state and federal law in this context raises some questions and concerns for directed trustees who are directed to sign tax returns. However, if the trust instrument vests all trustee powers relating to tax matters exclusively in a "tax matters trustee", the excluded trustee would not even be a trustee under applicable state law with respect to those tax matters and would not need to be a signatory on the return.

Similarly, a trustee of a directed trust with respect to investment matters may be directed to execute agreements in which certain representations and warranties are made by the directed trustee on behalf of the trust for an investment transaction. Could making those representations and warranties without personal knowledge of their accuracy subject the directed trustee to any risk of personal liability under federal law, such as securities laws or environmental laws? If trustee powers related to that type of investment are vested exclusively in the trustees that have intimate knowledge of the transaction, the excluded trustee would not even be a trustee under applicable state law with respect to that investment transaction and would not need to be a signatory on the document that makes the representations and warranties.

Although the excluded co-trustee arrangement can be an excellent alternative to the directed trustee arrangement under the right circumstances, an excluded co-trustee arrangement can raise its own set of unique issues.

Historically, the execution of a document on behalf of a trust has required that each trustee of the trust sign it, or that signatory authority be "delegated" by the non-signing trustees to the one executing the document. Under the Excluded Co-Trustee Statute, the trust instrument creating a trust with multiple trustees may vest one trustee with power for certain matters, to the exclusion of the other trustees, such that the non-excluded trustee, in its sole capacity, can bind the trust. A complete bifurcation of trustee power is not the equivalent of a delegation between co-trustees. However, the excluded co-trustee arrangement can and has led to confusion for third parties involved in trust transactions. An out-of-state financial institution who is undertaking a new account

opening for the trust, or the manager of a fund that the trust is investing in, might insist that all trustees sign transactional documents due to a lack of understanding of the impact of the Excluded Co-Trustee Statute.

In addition to the confusion with respect to the application of the Excluded Co-Trustee Statute, practitioners should carefully consider whether a particular excluded trustee arrangement creates a sufficient nexus to the State of Delaware. More specifically, in the event that the majority of trustee powers are executed exclusively by trustees located outside of the State of Delaware, could a court outside of the State of Delaware find that it has jurisdiction over the trust, that the trust is situated in another jurisdiction, or that a different jurisdiction's laws govern a particular matter? These issues may be of greater concern if the trust was originally created in another state and then later moved its situs to the State of Delaware. To minimize these concerns, the trust instrument could expressly provide (or be modified to provide) that Delaware law exclusively governs all or certain trust matters, even in the event that excluded trustee powers are exercised in jurisdictions outside of the State of Delaware. It is also helpful if the trust instrument grants exclusive administrative powers and duties to a trustee located in the State of Delaware, who is required to carry them out in the State of Delaware. Such administrative powers and duties may include some or all of the following: (i) to maintain an account to custody trust assets, receive trust income and make disbursements; (ii) to maintain storage of tangible personalty and evidence of intangible trust property; (iii) to maintain trust records and to originate, facilitate and review trust accountings, reports and other communications; (iv) to maintain an office for trustee meetings and other trust business; (v) to respond to inquiries concerning the trust from beneficiaries, trust fiduciaries and unrelated third parties; (vi) to execute documents in connection with performance of its duties; (vii) to retain accountants, attorneys, agents, and other advisers in connection with the performance of its duties; (viii) to prepare and file (or arrange for the preparation and filing of) income tax returns for the trust; and (ix) to allocate receipts, expenses, and distributions to income or principal in its discretion.

The Excluded Co-Trustee Statute governs the duties and liabilities of an excluded trustee when a trust instrument bifurcates trustee duties and responsibilities among co-trustees. As a relatively new statute, trust professionals are still exploring and developing the best ways in which the Excluded Co-Trustee Statute can be effectively utilized. The Excluded Co-Trustee Statute has tremendous potential to achieve flexibility in trust management in many desirable ways. This article is only a brief summary of some of its exciting uses and potential concerns.





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