Brown McCarroll L.L.P.

MEMORANDUM

TO: REPTL Council – Probate Side

FROM: William D. Pargaman

DATE: For Discussion October 5, 2007

RE: Proposed **2009** Trust Code Committee Projects

Table of Contents

Introduction and Summary

Please Don't Be Intimidated By The Length of This Memo!

In many instances, this memo includes the text of lengthy present and former statutory and uniform provisions **for background purposes only**. The actual recommendations of the Trust Code Committee are contained in boxes such as this one, so you may skip to those if you wish.

The Trust Code Committee (myself, Shannon Guthrie, Glenn Karisch, Leslie Amann, and Mike Cenatiempo), and Al Golden held a telephone conference on the afternoon of September 27th to discuss the matters addressed in this memo and make recommendations for the Council's consideration regarding legislative proposals relating to trust matters.

Here is a brief summary of the results of our review and recommendations for your consideration and input:

Items to Pursue on the Trust Code Wish List:

(The first two items are very minor, technical changes.)

- **Trustee Named as Beneficiary in Insurance Policy** – Section 1104.021 of the Insurance Code contains a reference to a trust that "designates a beneficiary" of a life insurance policy. This should be changed to a trust that "is designated as a beneficiary" of a life insurance policy.
- **Persons Who May Disclaim Interests in Trusts** – This minor change would add a reference to independent administrators, in addition to independent executors, as persons who may disclaim an interest in a trust.

(The next two items are more significant but should not present major drafting difficulties.)

- **Decanting Statute** – This change should be pursued after studying (and hopefully improving upon) similar statutes of other states.
- **Trustee's Power to Make Non-HEMS Distributions to Himself** – This change should be pursued after studying (and hopefully improving upon) similar statutes of other states.

(The last two items are important and will present substantial drafting difficulties.)

- **Protecting Directed Trustees** – While difficult to draft, this change should be pursued after studying (and hopefully improving upon) similar statutes of other states.
- **Addition of UTC-Like Provisions on Revocable Trusts** – While difficult to draft, this change should be pursued after studying (and hopefully improving upon) similar statutes of other states.

Non-Trust Code Committee Items for the Section to Consider (or Not):

- **Anti-*Jarboe* Amendment** – *Jarboe* is the April, 2007, bankruptcy decision that held that a nonspousal inherited IRA was no exempted by the Property Code provision exempting IRA's and other retirement plans. While Al questioned whether we should be exempting assets that clearly were not accumulated for the retirement of the debtor, others on the Committee pointed out that other assets, such as insurance proceeds, retained their exemption. Also, the proceeds could be protected through a properly-drafted trust beneficiary designation, but this is the hardest asset to get into a trust, so we'd be "penalizing" those less able to afford such sophisticated drafting. A majority of the Committee thought this was a worthwhile item to pursue.
- **Executor's Ability to Make Non-Pro Rata Division of Community Estate** – Stanley Johanson brought up the tax benefits of this again. I believe that two years ago the Council rejected giving this power unilaterally to an executor (over the objections of a surviving spouse), and that unless the power was unilateral in the statute, it might provide little tax benefit. But we raise the issue for reconsideration.

Items to Drop From the Wish List:

- **Allowing Designated Representative to Receive Notice On Behalf of Beneficiary** – We think we should wait at least a session or two before taking up this potentially difficult-to-draft change.
- **Adding the "Contents" of an Accounting to the List of Mandatory Rules** – We do not think this needs a legislative fix.
- **Spendthrift Trust – Sole Beneficiary/Trustee** – We do not think a clearly erroneous ruling regarding Texas law by a Florida bankruptcy judge justifies a legislative fix at this time.
- **Self-Settled Spendthrift Trusts** – We do not think this is an issue that the Section, as a whole, should take a position on. Our members have not reached a consensus.
- **Modified Rule Against Perpetuities** – We do not think this is an issue that the Section, as a whole, should take a position on. Our members have not reached a consensus.
- **Reformation to Correct Mistakes** – This would be a fairly clear departure from Texas law. Therefore, we do not recommend pursuing this.
- **Non-Pro Rata Distributions From Trusts** – This was actually adopted in 2005
- **Life Insurance as Only Trust Asset** – We think it best to leave this "nondiversification" exculpation up to the attorney who drafts a trust, rather than making it the default rule.

Trustee Named as Beneficiary in Insurance Policy
Insurance Code Section 1104.021 – Suggested by Prof. Stanley Johanson

On September 26th, Prof. Johanson brought to my attention several suggestions he says he's brought to REPTL's attention in the past that he believes remain good ideas. Here's one of them:

While in the Insurance Code and not the Trust Code – I've mentioned this two times in the past and nobody has picked up the ball: I wrote in a May 10, 2004 memorandum: In preparing for my Wills & Estates class and reviewing one of the statutes I assigned, I read it carefully, and look what it says:

> **§ 1104.021. Trustee Named as Beneficiary in Policy**
>
> (a) An individual may make a trust agreement providing that the proceeds of a life insurance policy insuring the individual be made payable to a trustee named as beneficiary in the policy. The validity of a trust agreement or declaration of trust that *designates a beneficiary* of a life insurance policy is not affected by whether any corpus of the trust exists in addition to the right of the trustee to receive insurance proceeds.

Needless to say, the italicize phrase should be revised to read: "that ***is designated as beneficiary*** of a life insurance policy..." I don't think there will be any litigation over the proper construction, because the first sentence of the statute makes it clear what this is about. Still.... Can we clean this up with a Technical Correction?

Recommendation: The committee thinks this is a noncontroversial change that should be included in our package.

Persons Who May Disclaim Interests in Trusts
Section 112.010(c)(3) – Suggested by Nikki DeShazo

Section 112.010(c)(3)[1] provides that an independent **executor** of a deceased beneficiary of a trust may disclaim an interest without court approval. Nikki pointed out that while the Probate Code defines "independent executor" to include "independent administrator" (see Section 3(q)),[2] there is no such definition in the Trust Code. Therefore, we should either (i) revise the reference in Section 112.010(c)(3) to refer to the independent executor **or independent administrator**, (ii) revise the reference in Section 112.010(c)(3) to refer to the personal representative of an estate under independent administration as provided in Section 145 of the Texas Probate Code, or (iii) search the Trust Code to see if there are any other references to independent executors or administrators, in which case maybe we should just add a definition of "independent executor" to Trust Code Section 111.004 similar to Probate Code Section 3(q).

Recommendation: The committee thinks this is a noncontroversial change that should be included in our package.

[1] Section 112.010(c) provides:

(c) Except as provided by Subsection (c-1) of this section, the following persons may disclaim an interest in a trust created in any manner other than by will:

(1) a beneficiary, including a beneficiary of a spendthrift trust;

(2) the personal representative of an incompetent, deceased, unborn or unascertained, or minor beneficiary, with court approval by the court having jurisdiction over the personal representative; and

(3) the independent executor of a deceased beneficiary, without court approval.

[2] Section 3(q) provides:

(q) "Independent executor" means the personal representative of an estate under independent administration as provided in Section 145 of this Code. The term "independent executor" includes the term "independent administrator."

Decanting Statute
Section 112.060-ish (?) – Suggested by TBA

Leslie Amann sent me the following in an e-mail discussing TBA's position on decanting provisions:

> Our group felt that a "decanting" statute (allowing a trustee who has absolute discretion to make distributions of trust assets from one trust to a new trust) might be useful to achieve a variety of goals, including: dealing with changed circumstances; modifying administrative provisions; altering trusteeship provisions; extending the termination date of trusts (for non-tax reasons); correcting drafting errors; converting a trust to a grantor trust or back; changing the governing law; dividing trust property to create separate trusts; and reducing potential liability.
>
> Several states already have variation on this including New York, Alaska, Delaware and Tennessee. Alaska's statute follows Delaware's lead, which allows decanting not only by a trustee who has absolute discretion but also by a trustee whose authority is limited by an ascertainable standard. However, unlike Delaware, Alaska has required that the ascertainable standard in the new trust be the same as that in the invaded trust. This limitation was added to prevent a trustee-beneficiary from having a general power. For example, consider a surviving spouse who is the sole trustee of the bypass trust created by the deceased spouse's will. If state law allowed the surviving spouse to decant the bypass trust to a new trust, which did not have an ascertainable standard, then arguably the trustee-beneficiary has a general power.

Recommendation: The committee thinks this merits further discussion, possibly resulting in a proposal for inclusion in our package. Leslie will follow up with sample decanting statutes from other states.

Trustee's Power to Make Non-HEMS Distributions to Himself
New Section 113.029? – Suggested by Prof. Stanley Johanson

On September 26th, Prof. Johanson brought to my attention several suggestions he says he's brought to REPTL's attention in the past that he believes remain good ideas. Here's one of them:

I've recommended this before, but here I go again. Several statutes have "disabling" statutes – protecting trustee-beneficiaries from attorneys who give them the power to distribute to themselves for (e.g.,) comfort, benefit, welfare, or well-being. Again, I'm not concerned about Cox & Smith or Barbara Anderson clients; but there are lawyers who don't know that the only real beneficiary of a power to distribute to oneself for "comfort" is the Internal Revenue Service. Why shouldn't we have a statute along the lines of the New York statute?

> NEW YORK ESTATES, POWERS & TRUST LAW §10-10.1: "***Power to distribute principal or allocate income; restriction on exercise.*** A power held by a person as trustee of an express trust to make a discretionary distribution of either principal or income to such person as a beneficiary, or to make discretionary allocations in such person's favor of receipts or expenses as between principal and income, cannot be exercised by such person unless (1) such person is the grantor of the trust and the trust is revocable by such person during such person's lifetime, or (2) the power is a power to provide for such person's health, education, maintenance or support within the meaning of sections 2041 and 2514 of the Internal Revenue Code, or any other ascertainable standard or (3) the trust instrument, by express reference to this section, provides otherwise. If the power is conferred on two or more trustees, it may be exercised by the trustee or trustees who are not so disqualified. If there is no trustee qualified to exercise the power, its exercise devolves on the supreme court or the surrogate's court, except that if the power is created by will, its exercise devolves on the surrogate's court having jurisdiction of the estate of the donor of the power.

Recommendation: The committee thinks this merits further discussion, possibly resulting in a proposal for inclusion in our package.

Protecting Directed Trustees
Section 114.003 – Requested by the Texas Bankers Association (Dave Folz/John Brigance)

Section 114.003 is designed to protect a trustee in situations where someone else is given the power to make certain decisions. Section 114.003 currently provides:

§ 114.003. POWERS TO DIRECT. (a) The terms of a trust may give a trustee or other person a power to direct the modification or termination of the trust.

(b) If the terms of a trust give a person the power to direct certain actions of the trustee, the trustee shall act in accordance with the person's direction unless:

(1) the direction is manifestly contrary to the terms of the trust; or

(2) the trustee knows the direction would constitute a serious breach of a fiduciary duty that the person holding the power to direct owes to the beneficiaries of the trust.

(c) A person, other than a beneficiary, who holds a power to direct is presumptively a fiduciary required to act in good faith with regard to the purposes of the trust and the interests of the beneficiaries. The holder of a power to direct is liable for any loss that results from a breach of the person's fiduciary duty.

The trustee **shall** act in accordance with that person's directions unless the direction is "manifestly contrary to the terms of the trust," or the trustee knows that the direction would constitute a "serious breach of a fiduciary duty" that the person holding the power to direct owes to the beneficiaries. The person holding the power is "presumptively" a fiduciary, but that leaves open the possibility that they're not.

TBA would like a more bright-line test for when they have to listen to, and when they have a duty to ignore, the person holding the power to direct. What is a "serious" breach of a fiduciary duty. They forwarded some proposed language initially in December of 2006. We (Glenn Karisch and I) told TBA that we agreed the test should be clearer, but we wanted more time to discuss this. By early March, TBA agreed this should wait until the 2009 session. But the following is their last attempt at suggested language, based on a Delaware statute:

§ 114.003. POWERS TO DIRECT. (a) Where one or more persons are given authority by the terms of a governing instrument to direct, consent to or disapprove a fiduciary's actual or proposed investment decisions, distribution decisions or other decision of the fiduciary, such persons shall be considered to be advisers and fiduciaries when exercising such authority unless the governing instrument otherwise provides.

(b) If the terms of the trust provide that a fiduciary is to follow the direction of an person given the power to direct and that person is acting in a fiduciary capacity, then except in cases of willful misconduct on the part of the fiduciary so directed, the fiduciary shall not be liable for any loss resulting directly or indirectly from any such act.

(c) If a governing instrument provides that a fiduciary is to make decisions with the consent of an adviser and that person is acting in a fiduciary capacity, then except in cases of willful misconduct on the part of the fiduciary, the fiduciary shall not be liable for any loss resulting directly or indirectly from any act

taken or omitted as a result of such adviser's failure to provide such consent after having been requested to do so by the fiduciary.

(d) For purposes of this section, "investment decision" means with respect to any investment, the retention, purchase, sale, exchange, tender or other transaction affecting the ownership thereof or rights therein, and an adviser with authority with respect to such decisions is an investment adviser.

Our initial thought was to make clear that someone, either the trustee or the power holder, had a fiduciary duty to the beneficiaries. However, upon further reflection, this may not be a good idea. Consider the typical provision allowing the surviving spouse to control whether a primary residence held in a bypass or marital trust should be retained or sold. Does she have to consider any fiduciary duties to other beneficiaries in exercising this power? Probably not. But neither should the trustee have to exercise a fiduciary duty regarding the sale or retention of the house in that situation. Maybe the answer is that the spouse is acting in a fiduciary capacity, but in the exercise of those duties, she is allowed to consider noneconomic factors, such as her wishes? But this seems like defining a fiduciary duty into nothingness.

On further reflection, it occurs to me that perhaps we should allow a power holder to have any power that the settlor could have originally put into the trust. In other words, maybe we don't say that either the trustee or the power holder has to act in a fiduciary capacity, but we make clear that the settlor can't give the power holder the power to do something that would violate the mandatory rules of Section 111.0035(b)?

The language of current Section 114.003 is derived from UTC Section 808. The language of UTC Section 808, and its comment, follows (with footnotes indicating changes from the uniform language in the 20 states that have adopted the UTC):

SECTION 808. POWERS TO DIRECT.[3] (a)[45] While a trust is revocable, the trustee may follow a [6]direction of the settlor that is contrary to the terms of the trust[78].

(b)[9] If the terms of a trust confer upon a person other than the settlor of a revocable trust power to direct certain actions of the trustee, the trustee shall act in accordance with an exercise of the power

---

[3] Utah omits this section entirely.
[4] Florida amends subsection (a) to read:
(a) Subject to §§ 736.0403(2) and 736.0602(3)(a), the trustee may follow a direction of the settlor that is contrary to the terms of the trust while a trust is revocable.
[5] Pennsylvania replaces the phrase "terms of the trust" with the phrase "trust instrument" throughout this section.
[6] Pennsylvania inserts the word "written" here.
[7] North Carolina adds here "…, even if in doing so (i) the trustee exceeds the authority granted to the trustee under the terms of the trust, or (ii) the trustee would otherwise violate a duty the trustee owes under the trust."
[8] Tennessee adds here "…or contrary to the normal practice of the trustee in regard to the action requested."
[9] Ohio amends subsection (b) to read:

[10]unless the attempted exercise is manifestly[11] contrary to the terms of the trust or the trustee knows the attempted exercise would constitute a serious breach of a fiduciary duty that the person holding the power owes to the beneficiaries of the trust.

(c) The terms of a trust may confer upon a trustee or other person a power to direct the modification or termination of the trust.

(d) A person, other than a beneficiary, who holds a power to direct[12] is presumptively[13] a fiduciary who, as such, is required to act in good faith with regard to the purposes of the trust and the interests of the beneficiaries. The holder of a power to direct is liable for any loss that results from breach of a fiduciary duty[14].[15]

Comment

Subsection (a) is an application of Section 603(a), which provides that a revocable trust is subject to the settlor's exclusive control as long as the settlor has capacity. Because of the settlor's degree of control, subsection (a) of this section authorizes a trustee to rely on a written direction from the settlor even if it is contrary to the terms of the trust. The written direction of the settlor might be regarded as an amendment of the trust. Subsection (a) has limited application upon a settlor's incapacity. An agent, conservator, or guardian has authority to give the trustee instructions contrary to the terms of the trust only if the agent, conservator, or guardian succeeds to the settlor's powers with respect to revocation, amendment, or distribution as provided in Section 602(e).

Subsections (b)-(d) ratify the use of trust protectors and advisers. Subsections (b) and (d) are based in part on Restatement (Second) of Trusts § 185 (1959). Subsection (c) is similar to Restatement (Third) of Trusts § 64(2) (Tentative Draft No. 3, 2001). "Advisers" 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. Subsection (c) ratifies the recent trend to grant third persons such broader powers.

A power to direct must be distinguished from a veto power. A power to direct involves action initiated and within the control of a third party. The trustee usually has no responsibility other than to carry out the direction when made. But if a third party holds a veto power, the trustee is responsible for initiating the decision, subject to the third party's approval. A trustee who administers a trust subject to a veto power occupies a position akin to that of a cotrustee and is responsible for taking appropriate action if the third party's refusal to consent would result in a serious breach of trust. See Restatement (Second) of Trusts § 185 cmt. g (1959); Section 703(g)(duties of cotrustees).

(b) As provided in section 5815.25 of the Revised Code, a trustee is not liable for losses resulting from certain actions or failures to act when other persons are granted certain powers with respect to the administration of the trust.

[10] Tennessee omits the balance of this sentence (beginning with the word "unless").

[11] Missouri omits the word "manifestly."

[12] Pennsylvania inserts the phrase "certain actions of a trustee" here.

[13] Oregon replaces the word "presumptively" with the phrase "rebuttably presumed."

[14] Wyoming adds here "…with respect to the holder's power."

[15] Tennessee adds the following subsection (e):

(e) In so following the directions under this section, the trustee is protected from liability as provided in T.C.A. §§35-3-122 and 123.

Frequently, the person holding the power is directing the investment of the holder's own beneficial interest. Such self-directed accounts are particularly prevalent among trusts holding interests in employee benefit plans or individual retirement accounts. See ERISA § 404(c) (29 U.S.C. § 1104(c)). But for the type of donative trust which is the primary focus of this Code, the holder of the power to direct is frequently acting on behalf of others. In that event and as provided in subsection (d), the holder is presumptively acting in a fiduciary capacity with respect to the powers granted and can be held liable if the holder's conduct constitutes a breach of trust, whether through action or inaction. Like a trustee, liability cannot be imposed if the holder has not accepted the grant of the power either expressly or informally through exercise of the power. See Section 701.

Powers to direct are most effective when the trustee is not deterred from exercising the power by fear of possible liability. On the other hand, the trustee does have overall responsibility for seeing that the terms of the trust are honored. For this reason, subsection (b) imposes only minimal oversight responsibility on the trustee. A trustee must generally act in accordance with the direction. A trustee may refuse the direction only if the attempted exercise would be manifestly contrary to 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.

The provisions of this section may be altered in the terms of the trust. See Section 105. A settlor can provide that the trustee must accept the decision of the power holder without question. Or a settlor could provide that the holder of the power is not to be held to the standards of a fiduciary. A common technique for assuring that a settlor continues to be taxed on all of the income of an irrevocable trust is for the settlor to retain a nonfiduciary power of administration. See I.R.C. § 675(4).

In June of 2006, Steve Akers also forwarded to me excerpts from the New Hampshire Trust Modernization and Competitiveness Act, designed, in part, to attract new trust business:

ARTICLE 12
TRUST PROTECTORS AND TRUST ADVISORS

564-B:12-1201 Trust Protector. The powers, duties and discretions of a trust protector shall be expressly set forth in the trust instrument and may, in the best interests of the beneficiaries, be exercised or not exercised in the sole and absolute discretion of the trust protector and shall be binding on all other persons. The powers, duties and discretions may include, without limitation, the following:

(a) To modify or amend the trust instrument to achieve favorable tax status or because of changes in the Internal Revenue Code, state law, or the rulings and regulations implementing such changes.

(b) To amend or modify the trust instrument to take advantage of changes in the rule against perpetuities, laws governing restraints on alienation, or other state laws restricting the terms of the trust, the distribution of trust property, or the administration of the trust.

(c) To appoint a successor trust protector.

(d) To review and approve the accountings of a trustee.

(e) To change the governing law or principal place of administration of the trust.

(f) To remove and replace any trust advisor for the reasons stated in the trust instrument.

(g) To remove a trustee, cotrustee, or successor trustee, for the reasons stated in the trust instrument, and appoint a successor.

(h) To consent to a trustee's or cotrustee's action or inaction in making distributions to beneficiaries if this power is not given exclusively to a trust advisor.

(i) To increase or decrease any interest of the beneficiaries in the trust, to grant a power of appointment to one or more trust beneficiaries, or to terminate or amend any power of appointment granted in the trust; however, a modification, amendment or grant of a power of appointment may not grant a beneficial interest in a charitable trust with only charitable beneficiaries to any non-charitable interest or purpose and may not grant a beneficial interest in any trust to the trust protector, the trust protector's estate, or for the benefit of the creditors of the trust protector.

564-B:12-1202 Trust Protector as a Fiduciary. Trust protectors are fiduciaries and the provisions of this chapter applicable to trustees shall be applicable to trust protectors, but only to the extent of the powers, duties and discretions granted to them under the terms of the trust instrument.

564-B:12-1203 Trust Advisor. The powers, duties and discretions of a trust advisor shall be expressly set forth in the trust instrument and may, in the best interests of the beneficiaries, be exercised or not exercised in the sole and absolute discretion of the trust advisor and shall be binding on all other persons. Such powers, duties and discretions may include, without limitation the following:

(a) To perform a specific duty or function that would normally be required of a trustee or cotrustee.

(b) To advise the trustee or cotrustee concerning any beneficiary.

(c) To consent to a trustee's or cotrustee's action or inaction relating to investments of trust assets.

(d) To direct the acquisition, disposition, or retention of any trust investment.

(e) To consent to a trustee's or cotrustee's action or inaction in making distributions to beneficiaries if this power is not given to a trust protector.

564-B:12-1204 Trust Advisor as a Fiduciary. Trust advisors are fiduciaries and the provisions of this chapter applicable to trustees shall be applicable to the trust advisors but only to the extent of the powers, duties, and discretions granted to them under the terms of the trust instrument.

564-B:12-1205 Trust Advisor and Trust Protector Subject to Court Jurisdiction. By accepting appointment to serve as a trust advisor or trust protector, the trust advisor or the trust protector submits to the jurisdiction of the courts of this state even if investment advisory agreements or other related agreements provide otherwise, and the trust advisor or trust protector may be made a party to any action or proceeding relating to a decision, action, or inaction of the trust advisor or trust protector.

564-B:12-1206 Duty to Review Actions of Trust Advisor or Trust Protector. An excluded fiduciary has no duty to review the actions of a trust protector or trust advisor including, without limitation, any duty or responsibility to perform investment reviews and make recommendations with respect to any investments to the extent the trust advisor or trust protector has the duty to direct the acquisition, disposition, or retention of any such investment.

564-B:12-1207 Fiduciary's Liability for Action or Inaction of Trust Advisor and Trust Protector. An excluded fiduciary is not liable for any loss resulting from any action or inaction of a trust advisor or trust protector or for any loss that results from the failure of a trust advisor or trust protector to take any action proposed by the excluded fiduciary that requires authorization of a trust advisor or trust protector if the excluded fiduciary timely sought but failed to obtain that authorization.

And in December of 2006, Will Hartnett sent an e-mail to Glenn asking for our thoughts on adopting a Delaware statute:

§ 3313. Advisers. (a) Where 1 or more persons are given authority by the terms of a governing instrument to direct, consent to or disapprove a fiduciary's actual or proposed investment decisions, distribution decisions or other decision of the fiduciary, such persons shall be considered to be advisers and fiduciaries when exercising such authority unless the governing instrument otherwise provides.

(b) If a governing instrument provides that a fiduciary is to follow the direction of an adviser, and the fiduciary acts in accordance with such a direction, then except in cases of wilful misconduct on the part of the fiduciary so directed, the fiduciary shall not be liable for any loss resulting directly or indirectly from any such act.

(c) If a governing instrument provides that a fiduciary is to make decisions with the consent of an adviser, then except in cases of wilful misconduct or gross negligence on the part of the fiduciary, the fiduciary shall not be liable for any loss resulting directly or indirectly from any act taken or omitted as a result of such adviser's failure to provide such consent after having been requested to do so by the fiduciary.

(d) For purposes of this section, "investment decision" means with respect to any investment, the retention, purchase, sale, exchange, tender or other transaction affecting the ownership thereof or rights therein, and an adviser with authority with respect to such decisions is an investment adviser.

(e) Whenever a governing instrument provides that a fiduciary is to follow the direction of an adviser with respect to investment decisions, distribution decisions, or other decisions of the fiduciary, then, except to the extent that the governing instrument provides otherwise, the fiduciary shall have no duty to:

(1) Monitor the conduct of the adviser;

(2) Provide advice to the adviser or consult with the adviser; or

(3) Communicate with or warn or apprise any beneficiary or third party concerning instances in which the fiduciary would or might have exercised the fiduciary's own discretion in a manner different from the manner directed by the adviser.

Absent clear and convincing evidence to the contrary, the actions of the fiduciary pertaining to matters within the scope of the adviser's authority (such as confirming that the adviser's directions have been carried out and recording and reporting actions taken at the adviser's direction), shall be presumed to be administrative actions taken by the fiduciary solely to allow the fiduciary to perform those duties assigned to the fiduciary under the governing instrument and such administrative actions shall not be deemed to constitute an undertaking by the fiduciary to monitor the adviser or otherwise participate in actions within the scope of the adviser's authority.

The Delaware statute is found in a chapter that applies to all sorts of fiduciaries (The term "fiduciary" shall mean trustees, personal representatives, guardians and custodians under the Uniform Gifts to Minors Act (Chapter 45 of this title) and other fiduciaries.), not just trustees.

Recommendation: The committee thinks this merits further discussion, although we acknowledge the difficulty of coming up with language that covers all of the issues appropriately. Al suggests we look at the guidelines under the delegation statute.

Addition of UTC-Like Provisions on Revocable Trusts
New Chapter ???? – Suggested by Bill Pargaman

The Uniform Trust Code contains an entire Article 6 dealing with issues related to revocable trusts that may not be adequately addressed in the rest of the Code. We have a Texas redraft of Article 6 prepared by Mike Cenatiempo's Texas UTC Study Subcommittee. The article contains the following provisions:

Article 6. Revocable Trusts

601. Capacity Of Settlor Of Revocable Trust
602. Revocation Or Amendment Of Revocable Trust
603. Settlor's Rights
604. Limitation On Action Contesting Validity Of Revocable Trust; Distribution Of Trust Property
605. Reservation Of Interests And Powers By Settlor

Mike Cenatiempo, who is on our Trust Code Committee, is working on an updated proposal for our consideration. The following is the list of issues he has outlined:

1. Execution/creation formalities.
   (A) Same as will?
   (B) Retain current law?
2. Mental capacity to create?
   (A) Same as will?
   (B) Retain current law?
3. Marital property management issues: separate property, sole management community property, joint management community property.
4. Divorce issues.
5. Creditor rights
   (A) Creditors existing at funding.
   (B) Creditors at death.
6. Funding issues (formal vs. informal funding; global vs asset by asset)
7. Revocation issues.
   (A) Reconcile property ownership/management issues
   (B) Formalities (personally, agent, guardian, court, notice(s) to trustee & others)
   (C) Return/delivery of property
8. Fiduciary duties.
   (A) Spouses as trustees

(B) One spouse incapacitated - duty of other spouse at that point.
(C) Rights of remaindermen

9. Homestead rights.

10. Property tax homestead issues.

11. Construction issues: ademption, order of abatement, tax apportionment, etc.

12. Clean up definitions

13. Reconcile statutes to the Certificate of Trust statute.

14. RAP - starting date.

Recommendation: The committee thinks this merits further discussion, possibly resulting in a proposal for inclusion in our package. We acknowledge that some revocable trust issues may be too difficult to solve, but we should deal with those issues where we feel there is a clear solution.

Allowing Designated Representative to Receive Notice On Behalf of Beneficiary
Section 111.0035? – Suggested (sort of) by Glenn Karisch

Last November, William Bullitt of Philadelphia asked on the ACTEC Practice e-mail list if there are states that expressly allow the settlor of a trust to direct that no notice be given to beneficiaries under any circumstances, or at least no notice to those who are not entitled to mandatory current distributions.

Jonathan Blattmachr of New York responded that Alaska permits this until the settlor dies. Bullitt responded that he was looking for a jurisdiction where, if the settlor said "don't tell my grandchildren they're beneficiaries until they're 50," the trustee could comply with the nondisclosure directive. Bruce Stone of Miami pointed out the provisions of new Florida statutes that went into effect July 1, 2007 (especially Sections 736.0301 and 0306).[16]

---

[16] **736.0301 Representation; basic effect.**–

(1) Notice, information, accountings, or reports given to a person who may represent and bind another person under this part may serve as a substitute for and have the same effect as notice, information, accountings, or reports given directly to the other person.

(2) Actions taken by a person who represents the interests of another person under this part are binding on the person whose interests are represented to the same extent as if the actions had been taken by the person whose interests are represented.

(3) Except as otherwise provided in s. 736.0602, a person under this part who represents a settlor lacking capacity may receive notice and give a binding consent on the settlor's behalf.

(4) A trustee is not liable for giving notice, information, accountings, or reports to a beneficiary who is represented by another person under this part, and nothing in this part prohibits the trustee from giving notice, information, accountings, or reports to the person represented.

736.0302 Representation by holder of power of appointment.–

(1) The holder of a power of appointment may represent and bind persons whose interests, as permissible appointees, takers in default, or otherwise, are subject to the power.

(2) Subsection (1) does not apply to:

(a) Any matter determined by the court to involve fraud or bad faith by the trustee;

(b) A power of a trustee to distribute trust property; or

(c) A power of appointment held by a person while the person is the sole trustee.

736.0303 Representation by fiduciaries and parents.–To the extent there is no conflict of interest between the representative and the person represented or among those being represented with respect to a particular question or dispute:

(1) A guardian of the property may represent and bind the estate that the guardian of the property controls.

(2) An agent having authority to act with respect to the particular question or dispute may represent and bind the principal.

(3) A trustee may represent and bind the beneficiaries of the trust.

(4) A personal representative of a decedent's estate may represent and bind persons interested in the estate.

(5) A parent may represent and bind the parent's unborn child, or the parent's minor child if a guardian of the property for the minor child has not been appointed.

736.0304 Representation by person having substantially identical interest.–Unless otherwise represented, a minor, incapacitated, or unborn individual, or a person whose identity or location is unknown and not reasonably ascertainable, may be represented by and bound by another person having a substantially identical interest with

Recommendation: The committee thinks that consideration of any change along these lines should be postponed for a session or two, given the potential drafting difficulty and the number of changes we've already made recently to Section 111.0035. Mike suggests that when and if this is considered, incapacity of the settlor, not just death, might be considered a triggering event.

---

respect to the particular question or dispute, but only to the extent there is no conflict of interest between the representative and the person represented.

736.0305 Appointment of representative.–

(1) If the court determines that an interest is not represented under this part, or that the otherwise available representation might be inadequate, the court may appoint a representative to receive notice, give consent, and otherwise represent, bind, and act on behalf of a minor, incapacitated, or unborn individual, or a person whose identity or location is unknown. If not precluded by a conflict of interest, a representative may be appointed to represent several persons or interests.

(2) A representative may act on behalf of the individual represented with respect to any matter arising under this code, whether or not a judicial proceeding concerning the trust is pending.

(3) In making decisions, a representative may consider general benefits accruing to the living members of the represented individual's family.

736.0306 Designated representative.–

(1) If authorized in the trust instrument, one or more persons may be designated to represent and bind a beneficiary and receive any notice, information, accounting, or report.

(2) Except as otherwise provided in this code, a person designated, as provided in subsection (1) may not represent and bind a beneficiary while that person is serving as trustee.

(3) Except as otherwise provided in this code, a person designated, as provided in subsection (1) may not represent and bind another beneficiary if the person designated also is a beneficiary, unless:

(a) That person was named by the settlor; or

(b) That person is the beneficiary's spouse or a grandparent or descendant of a grandparent of the beneficiary or the beneficiary's spouse.

(4) No person designated, as provided in subsection (1), is liable to the beneficiary whose interests are represented, or to anyone claiming through that beneficiary, for any actions or omissions to act made in good faith.

Adding the "Contents" of an Accounting to the List of Mandatory Rules
Section 111.0035 – Suggested by Prof. Stephen Alton of Texas Weslayan

In April, Prof. Stephen Alton forwarded to Will Hartnett a list of suggested additions to the laundry list of mandatory rules contained in Section 111.0035(b) that settlors may not draft around ("a few oversights," in his words). Will forwarded the list to Glenn, who forwarded them to me. I did not think that any of them merited action in the 2007 legislative session. However, there was one that I thought the committee should consider for possible action in 2009.

Section 111.0035(b)(5)(a) lists the ability of a beneficiary to demand an accounting under Section 113.151 as a mandatory provision. However, it does not list Section 113.152, which contains the required contents of a the accounting. Prof. Alton questions whether this allows a settlor to "vary the contents of the required accounting under section 113.152 all the way down to no information." He admits this may be hypertechnical.

My response at the time was that he **was** being hypertechnical. However, I have to admit that perhaps this should at least be considered by the entire committee.

Recommendation: The committee thinks that no legislative change is advisable, especially given the number of changes we've already made recently to Section 111.0035.

Spendthrift Trust – Sole Beneficiary/Trustee
Section 112.035 – Brought to our attention by Robert Meyer (Florida attorney)

In a recent Florida bankruptcy case, the court held that the sole beneficiary/trustee of a Texas trust was not entitled to spendthrift protection under Section 112.035. Even though the beneficiary/trustee was not really the sole beneficiary (there were contingent beneficiaries upon his death), the Florida court held that he was the sole beneficiary. Then, relying on Section 115(5), Restatement 2nd Trusts (("The sole trustee of a trust cannot be the sole beneficiary of the trust.") and 99(5) of Restatement 2nd Trusts ("The sole beneficiary of a trust cannot be the sole trustee of the trust."), the court held there is merger in Texas when the trustee is "the" beneficiary. Due to the "merger," the court annulled the spendthrift protection.

This case is wrongly decided (at least based on the facts represented to us). For one thing, there doesn't appear to be a "sole beneficiary." But is a wrongly-decided Florida case worth a Texas legislative remedy?

Recommendation: The committee thinks that no legislative change is advisable, although members of the committee are willing to provide letters to the effect that the Florida judge's decision is wrong.

On a separate note, we discussed whether the Council ought to take a position on the *Jarboe* case that held that a nonspousal inherited IRA is not exempt from creditors' claims. Al is not sure that the result in *Jarboe* is wrong from a public policy standpoint. However, at least a majority of the committee though a legislative reversal/clarification was in order. (**Note:** This is **not** a Trust Code issue.)

Self-Settled Spendthrift Trusts
Section 112.035 (?) – Suggested by TBA

Leslie Amann sent me the following in an e-mail discussing TBA's position on self-settled spendthrift trusts:

> This is another measure that our group feels would give Texas a competitive edge; although, you will recognize that this is an area where the members of the TBA Wealth Management and Trust Division might have a different perspective than the traditional bankers who are credit focused. The compromise measures that were discussed include an approach that includes mandated statutory caps in amount (Okla. has $1MM, I believe) or time limits (creditor protection does not attach until the funds have been in the trust for a specified period of years). This is another area where anecdotal evidence suggests that certain segments (doctors and lawyers) tend to move investments into annuities to achieve creditor protection. (That protection is afforded by statute also, so the idea is not without precedent.)

This could be a politically controversial change. We should discuss whether the Committee feels we should take a position on it. We haven't in the past, or at least we haven't supported this concept, when expanding spendthrift protection for non-settlor beneficiaries.

Recommendation: The committee thinks that the Section should take no position on this, although we recognize that individual members of the Section may take [strong] positions if this is proposed by TBA.

Modified Rule Against Perpetuities
Section 112.036 – Suggested by TBA

Leslie Amann sent me the following in an e-mail discussing TBA's position on the RAP:

> The consensus is that there is ample anecdotal evidence that not modifying the RAP causes business (and money) to flow to other jurisdictions. The group discussed the relative merits of repealing the RAP but excluding real estate, extending RAP to a period greater than 150 years, and other various compromises that have been put in effect in other jurisdictions regarding this issue. We referred to an article that might be of interest to you – *Jurisdictional Competition for Trust funds: An Empirical Analysis of Perpetuities and Taxes*. Yale LJ 115:356 – here is a link:
>
> http://yalelawjournal.org/115/2/356_robert_h_sitkoff_max_m_schanzenbach.html
>
> Probably more than you want to know – it is nearly 100 pages – but it contains some interesting information. The abstract summarizes its findings that a state may increase its reported trust assets by as much as 20% by repealing the rule although efforts to tax that increased economic benefit are less clearly successful.

Traditionally, not only our Committee, but the entire REPTL Section, has stayed out of taking an official position regarding repeal or modification of the rule against perpetuities.

Recommendation: The committee thinks that the Section should take no position on this, although we recognize that individual members of the Section may take [strong] positions if this is proposed by TBA.

Reformation to Correct Mistakes
Section 112.054-ish – Sort of suggested by Michelle Clayton (NCCUSL)

We have now included the substance of most of the UTC modification provisions in Section 112.054. Michelle Clayton, Legislative Counsel to NCCUSL, asked Glenn in June of 2006 if we had adopted UTC Section 415,[17] which allows a court to reform a trust in the event the terms of the trust were affected by a mistake. Glenn let Michelle know that we haven't adopted it.

---

[17] **SECTION 415. REFORMATION TO CORRECT MISTAKES**. The court may reform the terms of a trust, even if unambiguous, to conform the terms to the settlor's intention if it is proved by clear and convincing evidence that both the settlor's intent and the terms of the trust were affected by a mistake of fact or law, whether in expression or inducement.

Comment

Reformation of inter vivos instruments to correct a mistake of law or fact is a long-established remedy. Restatement (Third) of Property: Donative Transfers Section 12.1 (Tentative Draft No. 1, approved 1995), which this section copies, clarifies that this doctrine also applies to wills.

This section applies whether the mistake is one of expression or one of inducement. A mistake of expression occurs when the terms of the trust misstate the settlor's intention, fail to include a term that was intended to be included, or include a term that was not intended to be included. A mistake in the inducement occurs when the terms of the trust accurately reflect what the settlor intended to be included or excluded but this intention was based on a mistake of fact or law. See Restatement (Third) of Property: Donative Transfers Section 12.1 cmt. i (Tentative Draft No. 1, approved 1995). Mistakes of expression are frequently caused by scriveners' errors while mistakes of inducement often trace to errors of the settlor.

Reformation is different from resolving an ambiguity. Resolving an ambiguity involves the interpretation of language already in the instrument. Reformation, on the other hand, may involve the addition of language not originally in the instrument, or the deletion of language originally included by mistake, if necessary to conform the instrument to the settlor's intent. Because reformation may involve the addition of language to the instrument, or the deletion of language that may appear clear on its face, reliance on extrinsic evidence is essential. To guard against the possibility of unreliable or contrived evidence in such circumstance, the higher standard of clear and convincing proof is required. See Restatement (Third) of Property: Donative Transfers Section 12.1 cmt. e (Tentative Draft No. 1, approved 1995).

In determining the settlor's original intent, the court may consider evidence relevant to the settlor's intention even though it contradicts an apparent plain meaning of the text. The objective of the plain meaning rule, to protect against fraudulent testimony, is satisfied by the requirement of clear and convincing proof. See Restatement (Third) of Property: Donative Transfers Section 12.1 cmt. d and Reporter's Notes (Tentative Draft No. 1, approved 1995). See also John H. Langbein & Lawrence W. Waggoner, Reformation of Wills on the Ground of Mistake: Change of Direction in American Law?, 130 U. Pa. L. Rev. 521 (1982).

For further discussion of the rule of this section and its application to illustrative cases, see Restatement (Third) of Property: Donative Transfers Section 12.1 cmts. and Reporter's Notes (Tentative Draft No. 1, approved 1995).

Recommendation: The committee thinks that no legislative change is advisable, given that we think this would be a significant change to Texas law, and there likely would not be a consensus among our members.

Non-Pro Rata Distributions From Trusts
Section 113.027? – Suggested by Prof. Stanley Johanson

On September 26th, Prof. Johanson brought to my attention several suggestions he says he's brought to REPTL's attention in the past that he believes remain good ideas. Here's one of them:

Here is major revision to consider, inspired by two recent PLRs I will be talking about in this year's [actually, the 2004!] edition of my Recent Developments outline. The rulings remind us that non-pro rata distributions out of a trust are realization events (says the Service—correctly) unless authorized by the governing instrument or state law. The current Texas statute (§112.053) merely provides that "The settlor may provide in the trust instrument how property may or may not be disposed of in the event of failure, termination, or revocation of the trust." I know that the governing instruments you guys draft authorize non-pro rata distributions, but how about the clients of less experienced attorneys? It seems to me that "non-pro rata distributions" should be the default rule, especially since (I suspect) more than a few individual trustees, and their attorneys, assume there's nothing wrong with non-pro rata distributions.

A. **Is a non-pro rata distribution from a trust a realization event?** Yes, says Rev. Rul. 69-486, 1969-2 C.B. 159, if the trustee is not authorized to make non-pro rata distributions. The distribution is treated as a pro rata distribution followed by an exchange between the beneficiaries, making the distribution a realization event under §1001.

1. **Not if non-pro rata distributions are authorized by the governing instrument**. So ruled in Ltr. Rul. 200328032, involving a grandfathered GST trust that was to be divided into four trusts. The Service ruled that the division will not cause recognition of gain or loss because the trustees have the power to act as they deem proper in any partition of the trust property

2. **… or if non-pro rata distributions are authorized by state law**. In Ltr. Rul. 200334030, a testamentary trust had many a number of real estate holdings. The trustees and most (but not all) of the beneficiaries wanted the trust assets to be maintained as an on-going business venture after the trust terminated. The majority of the trust assets would be contributed to a limited liability company, in which the trust would be the controlling member. Trust beneficiaries would be given the option of requesting the type of assets (cash, LLC interest, or in-kind property) to be distributed to them upon the trust's termination. Thus, the distributions received by the beneficiaries would not be pro rata. The Service noted that although the trust terms allowed for partitioning of the trust upon the trust's termination, there was no express language authorizing non-pro rata distributions. However, a state statute authorizes non-pro rata distributions from a trust. That eliminates the problem, said the Service. The proposed distribution will not cause either the trust or its beneficiaries to realize gain or loss.

On another front (and possibly more controversial), I have always been concerned about the fact that in many, many decedents' estates, I suspect that non-pro rata distributions are commonplace, almost routine. This is often true of community property, as well as the residuary estate of a single person, where the decedent devises portions of the community estate to someone other than the surviving spouse. If the instrument authorizes non-pro rata distributions, fine; but if not, the default rule is pro rata. While the §1001 concern is not as great (as the assets will have acquired a new basis under §1014), in many cases the estate is not distributed until two or three years have elapsed, and there may have been more-than-modest appreciation in the intervening years. I'm not sure what to suggest for cases of intestacy (see Probate Code §380—have either of you ever had commissioners appointed???), but for cases involving wills, how about a default rule that authorizes an independent executor to make non-pro rata jurisdictions (just like Brown McCarroll or Cox & Smith wills now provide)?

(**Note from WDP:** The non-pro-rata distribution from trust issue was dealt with in Section 113.027 added in 2005. While not under the Trust Code Committee's jurisdiction, I believe the Council considered and rejected the non-pro-rata distribution provision for decedent's estates because to work for tax purposes, we'd have to give the executor the power to make a non-pro-rata division of the community estate **without** the surviving spouse's consent.)

Recommendation: No legislative change is needed. In a follow-up e-mail, Prof. Johanson acknowledged that Section 113.027 deals with the trust issue. And no one on the Committee has any desire to revisit a proposal to give the power to an executor to divide community property without consent of the surviving spouse.

Life Insurance as Only Trust Asset
New Section 113.059? – Suggested by Prof. Stanley Johanson

On September 26th, Prof. Johanson brought to my attention several suggestions he says he's brought to REPTL's attention in the past that he believes remain good ideas. Here's one of them:

Several states have statutes along the lines of Va. Code Ann. §26-45.1: When life insurance policies are held by a trust, the trustee has no duty to (i) determine the appropriateness of any particular policy as a trust investment, (ii) dispose of any policy in order to diversify trust assets, or (iii) exercise any policy options.

(**Note from WDP:** I tried to find the statute Stanley refers to, but it appears it was repealed in 1999 effective January 1, 2000.)

Recommendation: The committee thinks that no legislative change is advisable, especially given that the statute Prof. Johanson cites was repealed seven years ago.