



Not Your Father's Trust



Scenario 1: You name a sibling or friend as trustee of your grown kids' inheritance because they're not ready to control it. You trust the trustee more than you do your kids or the courts, and you're told you can create a trust that limits or even eliminates many traditional trustee duties, allowing the trustee freedom to make the decisions she thinks best without fear of being sued.

Scenario 2: You name a financial institution as trustee of your grown kids' inheritance for the same reason. You accept the professional trustee's standard trust language without realizing that it limits or even abolishes some traditional trustee duties, resulting in the financial institution serving with greatly reduced concern about being sued.

What is a "Trust?"

Those of us who went to law school used to know what a trust was, but in Tennessee we need to update our understanding.¹

Centuries of western common law defined what a trust was, and a generation ago the Uniform Trust Code (UTC), adopted in Tennessee (with changes) in 2004 (Tennessee Trust Code, or TTC),² sought to codify the state of the law. The traditional view says a "settlor" transfers assets to a "trustee," who holds, invests, manages and distributes the assets for the benefit of, and owes fiduciary duties to, the "beneficiaries," pursuant to the terms of the trust instrument. Among the duties the trustee generally has are good faith,³ loyalty⁴ and impartiality.⁵ Many duties are waivable, but without

certain enforceable duties (at least good faith) you do not have a trust.⁶ The trustee must satisfy fiduciary duties "as a prudent person would ... [exercising] reasonable care, skill and caution."⁷

Tennessee Trust Business

Beginning with the enactment of the TTC, Tennessee has pursued new trust business through significant changes to its trust law.⁸ A major theme of the changes is allowing settlors to craft the terms they want, without necessarily being moored to traditional trust concepts. Among the more dramatic changes are those that allow narrowing or eliminating traditional trustee fiduciary duties.

Waivable and Nonwaivable Duties

Tennessee Code Annotated § 35-15-105(b) contains a list of nonwaivable fiduciary duties, including the duty "to act in accordance with the terms and purposes of the trust and the interests of the beneficiaries" and the "requirement that a trust and its terms be for the benefit of its beneficiaries as the interests of such beneficiaries are defined under the terms of the trust, and that the trust has a purpose that is lawful and possible to achieve."⁹ *Tenn. Code Ann.* § 35-15-105(a) and (b) provide that the trust instrument may alter or override anything not included in *Tenn. Code Ann.* § 35-15-105(b), and *Tenn. Code Ann.* § 35-15-105(a) explicitly provides:

The terms of a trust may expand, restrict,

eliminate or otherwise vary the duties and powers of a trustee ... and the rights and interests of a beneficiary. ... Except as restricted by subsection (b), ... courts shall give maximum effect to the principle of freedom of disposition and to the enforceability of trust instruments.

Thus, if not limited elsewhere in TTC, waivable duties include the duties of skill, care, prudence, loyalty and even the duty of good faith.¹⁰

Silent Trusts

A Tennessee trust instrument may limit or eliminate the trustee's duty to report to the beneficiaries. The default rules under *Tenn. Code Ann.* § 35-15-813 provide that the trustee must (1) notify certain beneficiaries upon funding of the trust, (2) keep current mandatory or permissible beneficiaries "reasonably informed about the administration of the trust and of the material facts necessary for them to protect their interests" and (3) respond to reasonable requests for information from a "qualified beneficiary."¹¹ However, such duties are not in the mandatory rules of *Tenn. Code Ann.* § 35-15-105(b), and *Tenn. Code Ann.* § 35-15-813(e) explicitly states that the terms of the trust may override the duty to report. If the trustee is not required to inform the beneficiaries of what is happening in the trust or even of the trust's existence, then the beneficiaries are unable to enforce the terms of the trust.

Tenn. Code Ann. § 35-15-1201 allows the appointment of a trust protector or trust advisor and the trust instrument can require the trustee to report to that person rather than a beneficiary. Such an arrangement is helpful when a beneficiary is troublesome or the settlor does not want knowledge of the trust to undermine a beneficiary's incentives to be independent. However, the trust can provide that the trust protector/advisor has no fiduciary duties to the beneficiaries, leaving a trustee with no duty to report to the beneficiaries and a trust protector/advisor with no fiduciary duty to protect the beneficiaries.¹² Some trusts go even

further by providing that the trustee has no obligation to report to anyone, a truly "silent trust."

Directed Trusts

A Tennessee trust instrument may bifurcate traditional trustee powers, giving a trustee (an "excluded fiduciary") certain powers and someone else (another trustee or a trust protector/advisor) other powers.¹³ Whenever an excluded fiduciary is to follow the direction of another with respect to investments, distributions or other decisions, the default rules are that the excluded fiduciary shall have no duty to (1) review, evaluate or in any other way monitor the conduct of the other person; (2) make recommendations or evaluations, consult with or in any way provide advice to the other person; or (3) communicate with or warn or apprise any beneficiary or third party concerning any differing approach the excluded fiduciary might have taken.¹⁴ The excluded fiduciary has no obligation to monitor the actions or inactions of the person possessing excluded powers.¹⁵ As stated above, the trust protector/advisor might have no fiduciary duties to the beneficiaries, leaving a trustee with no duty to oversee the trust protector/advisor and the trust protector/advisor with no fiduciary duty to protect the beneficiaries.¹⁶

There appears to be some ambiguity in Tennessee law on this point. The Comment to *Tenn. Code Ann.* § 35-15-105 (emphasis added) says:

[A] settlor may not so negate the responsibilities of a trustee that the trustee would no longer be acting in a *fiduciary* capacity. Notwithstanding the preceding sentence, in a directed trust one or more fiduciary powers and duties can be removed from a trustee and given to another *fiduciary*, in which case relative to the powers and duties so removed, that trustee will be an excluded fiduciary.

However, nothing in Tennessee's directed trust statutes (*Tenn. Code Ann.* § 35-15-710; *Tenn. Code Ann.* § 35-15-808), the statutes

addressing trust advisors/protectors (*Tenn. Code Ann.* §§ 35-15-1201 et seq.) or the official comments to any of them require that the trust advisor/protector have any fiduciary duties. In fact, the Comment to *Tenn. Code Ann.* § 35-15-1202 explicitly says that, although a trust advisor/protector is by default a fiduciary, the trust instrument may provide otherwise.

Decanting

Many trusts give a trustee discretion to distribute trust income and principal among several beneficiaries. *Tenn. Code Ann.* § 35-15-816(c) provides that such a trustee, instead of distributing assets outright, may "decant" trust assets to a "second trust"¹⁷ for the benefit of one or more "proper objects of the exercise of the power."¹⁸ Trustees commonly use the decanting power to alter trust terms.

Are there any fiduciary limits on decanting power? A New Hampshire Supreme Court case ruled a series of decantings that removed several beneficiaries, apparently viable under the language of the New Hampshire statute, were void ab initio because the trustees failed to give any consideration to the plaintiffs' beneficial interests, thereby violating the statutory duty of impartiality.¹⁹ However, if the trust instrument eliminates the duty of impartiality, the trustee appears to have unfettered discretion. Even where the duty of impartiality is not expressly eliminated, in Tennessee "[a] reasonableness standard shall not be applied to the exercise of discretion by the trustee with regard to a discretionary interest."²⁰ Further, "[a]bsent express language in the trust instrument to the contrary," if the trust language "permits unequal distributions between beneficiaries or distributions to the exclusion of other beneficiaries, the trustee may distribute all income and principal to one beneficiary."²¹ Lastly, a court might have limited jurisdiction to review a trustee's exercise of discretion.²²

Exculpation Clauses

Tenn. Code Ann. § 35-15-1008 provides that a provision relieving a trustee of liability for breach of trust is unenforceable to the extent (implying only to the extent) that it (among other things) relieves the trustee of liability for breach of trust committed in bad faith or

EDDY SMITH practices with Kennerly Montgomery in Knoxville. He focuses on planning, administration, and litigation related to trusts, estates, businesses and nonprofits. Smith is a fellow of The American College of Trust and Estate Counsel and served as chair of the TBA Estate Planning and Probate Section.

with reckless indifference to the purposes of the trust or the interests of the beneficiaries. However, we've already seen that the duty of good faith can be waived by the trust instrument, so the effect of this statute is unclear.

Creditor and Tax Concerns?

How far should settlors and their lawyers go in limiting or eliminating fiduciary duties? If a settlor transfers property to someone who has no fiduciary duties to the beneficiaries or anyone else on behalf of the beneficiaries, or gives neither the beneficiaries nor anyone else the power to review the trustee's actions and hold the trustee or trust advisor/protector accountable for failing those fiduciary duties, then the settlor has effectively given the recipient a fee simple interest in the property.²³

Removing fiduciary duties can negatively impact protection against creditor claims and taxes. Lawyers and their clients should be concerned whether creditors of the person called a trustee or trust advisor can get to trust assets because they are not protected by fiduciary duties to the beneficiaries. Similarly, many desirable tax results are obtained in reliance on a person's fiduciary duties. If those duties have been limited or eliminated, might taxable income of the trust be considered taxable income of the "trustee?" Might trust assets be includible in the taxable estate of the "trustee" because the "trustee," owing no duties to others, is treated as the fee owner?

Client Education

These developments challenge traditional notions of a trust. Flexibility in crafting a trust, by itself, is arguably a good thing. Our laws recognize that a key incident of property ownership is the ability to transfer that property to intended beneficiaries on terms the donor chooses. Loosing the reins on trust transfers allows settlors to do a wider variety of things with more creativity than in the past.

However, calling something a "trust" does not necessarily mean what it used to mean, a dynamic that can create confusion among lawyers and their clients. "The concern is I may not understand that, by eliminating all fiduciary duties, I am effectively making [the

trustee], rather than [the beneficiary], the donee."²⁴ Lawyers modifying or eliminating default duties (or failing to bolster duties and standards considering TTC's relaxing of duties and standards) must counsel clients about the potential implications of doing so. Of particular concern might be corporate trustee forms, drafted in service of flexibility and marketing, that create something that settlors do not recognize as a trust. Perhaps a better description than "trust" in some situations is a "precatory gift" or "trusting gift." Make sure your clients know the difference. ■■■

NOTES

1. The author thanks attorney Dan W. Holbrook of Egerton, McAfee, Armistead & Davis, P.C. in Knoxville and Jeffrey Schoenblum, Centennial Professor of Law, Vanderbilt Law School, for their insights and perspectives regarding issues addressed herein.

2. See Uniform Trust Code, 2003, available at https://bit.ly/UTC_2003. Some provisions of TTC do not apply to trusts that existed (or at least were irrevocable) prior to TTC's general effective date of July 1, 2004.

3. The duty of good faith, codified in Tennessee as *Tenn. Code Ann.* § 35-15-801, requires that the trustee not act fraudulently or in bad faith or engage in willful misconduct.

4. The trustee must act "solely in the interests of the beneficiaries" (manage conflicts of interest). *Tenn. Code Ann.* § 35-15-802.

5. The trustee is to administer the trust "giving due regard to the beneficiaries' respective interests" *Tenn. Code Ann.* § 35-15-803.

6. Vanderbilt law professor Jeffrey Schoenblum notes the common law principle of a trust's "irreducible core duties," requiring at least a duty of good faith and the right and practical ability of the beneficiaries to hold the trustee accountable. Schoenblum, "The Nonfiduciary Trust," 46 *ACTEC Law Journal* 357, 359 (Summer 2021).

7. *Tenn. Code Ann.* § 35-15-804. "A trustee who has special skills or expertise, or is named trustee in reliance upon the trustee's representation that the trustee has special skills or expertise, shall use those special skills or expertise." *Tenn. Code Ann.* § 35-15-806.

8. See Smith, "If You Build It, They Will Come: Tennessee Pursues Trust Preeminence," *Tennessee Bar Journal*, September 2021, available at www.tba.org/Smith_TrustPreeminence; Holbrook, "3 Developments Enhance Tennessee's Drive to Be a Top Trust Situs," *Tennessee Bar Journal*, August 2019, available at www.tba.org/Holbrook_TopTrustSitus; Smith, "Shifting the Paradigm: Should Most Tennessee Trusts Last Indefinitely?"

Tennessee Bar Journal, December 2017, available at www.tba.org/Smith_ShiftingtheParadigm; Smith, "In Tennessee, 'T' Stands for Trust," *Tennessee Bar Journal*, April 2017, available at www.tba.org/Smith_TStandsTrust.

9. *Tenn. Code Ann.* § 35-15-105(b)(2)-(3) (emphasis added). The Tennessee General Assembly added the italicized language after initial enactment, and later removed "not contrary to public policy" as a nonwaivable requirement.

10. The Comment to *Tenn. Code Ann.* § 35-15-105 says a settlor "can relieve a fiduciary from acting in good faith (such not being included in *Tenn. Code Ann.* § 35-15-105(b)(2)."

11. Defined in *Tenn. Code Ann.* § 35-15-103(24).

12. The default rules under *Tenn. Code Ann.* § 35-15-1202 are that a trust protector or advisor is a fiduciary and must act in good faith and in the interests of the beneficiaries, but both those duties can be overridden by the trust instrument. See Comment to *Tenn. Code Ann.* § 35-15-1202.

13. *Tenn. Code Ann.* §§ 35-15-103(12), 35-15-710.

14. *Tenn. Code Ann.* § 35-15-1204.

15. See also *Tenn. Code Ann.* § 35-15-1205. A directed trust with an excluded fiduciary is contrasted with a trustee's delegation of fiduciary duties. Pursuant to *Tenn. Code Ann.* § § 35-15-807, a delegating trustee has an ongoing duty to review the agent's actions.

16. See *Tenn. Code Ann.* § § 35-15-1201, 35-15-1202 (incl. Comment), and 35-15-105(b).

17. "Second trust" can mean the original trust after "modification or restatement" under this section and does not require retitling property titled to the original trust. Accordingly, a trustee who has discretion to distribute all the trust principal to one or more of a group of beneficiaries can do unilaterally what otherwise would require consent of the qualified beneficiaries under *Tenn. Code Ann.* § 35-15-411.

18. Decanting may not violate certain tax rules, may not add new beneficiaries, and may accelerate the beneficial interest of a future beneficiary only after the settlor's death. There are other limitations, including for a trustee who is also a beneficiary.

19. *Hodges v. Johnson*, 177 A.3d 86 (N.H. 2017).

20. *Tenn. Code Ann.* § 35-15-814(b)(3).

21. *Tenn. Code Ann.* § 35-15-814(b)(5).

22. *Tenn. Code Ann.* § 35-15-814(b)(4).

23. See Schoenblum, *supra* note 6. "[E]liminating all fiduciary duties would make the trust illusory." Langbein, "Mandatory Rules in the Law of Trusts," 98 *Nw. Univ. L. Rev.* 1105 (2004).

24. Langbein, *supra* note 23, at 1122-23.