

DRAFTING CONSIDERATIONS UNDER THE UNIFORM TRUST CODE

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January 9, 2003

Adoption of the Connecticut Uniform Trust Code (the "CUTC") will for the first time provide Connecticut attorneys, trustees and beneficiaries with a clear, comprehensive and well organized codification of the law of Trusts. Current Connecticut black letter law on Trusts is disorganized, woefully inadequate and has developed on a piecemeal basis over the years in response to specific problems as opposed to being a comprehensive code. The CUTC answers numerous questions and resolves issues that have plagued Connecticut attorneys for years. In addition, CUTC provides a framework for resolving problems presented by poorly drafted trust documents or substantially changed circumstances. For the most part, the CUTC establishes "default" rules that apply unless the terms of the trust provide otherwise. The CUTC does, however, contain certain "mandatory" rules that cannot be changed by the trust agreement. These mandatory rules can be found in section 5 of the CUTC (section 105 of the pure Uniform Trust Code, the "UTC"). Given the fact that the CUTC is a comprehensive code, there are going to be default (non-mandatory) provisions that individual settlors will want to change. The purpose of this outline is to identify some of the more significant areas that attorneys may want to focus on when drafting documents under the CUTC.

I. Duties and Powers of Trustee (sections 58-70 CUTC; Article 8 UTC).

A. Duty of Loyalty (sec. 59 CUTC; sec. 802 UTC). This section contains very detailed and strict rules regarding what constitutes a breach of a trustee's duty of loyalty to the beneficiaries. For example, (1) a sale, encumbrance, or other transaction involving the investment or management of trust property in which the trustee or someone related to the trustee has an interest; (2) management for personal gain of a business forming a part of the trust and controlled by the trustee; and (3) transactions between a trustee and a beneficiary not involving trust property, but where the trustee may have an advantage by virtue of the existence of the trust. This section establishes very strict rules to insure loyalty. However, these rules can be modified to meet the needs of a particular trust. Simple examples would be situations where the settlor wants the trustee to be able to purchase or use trust property or invest trust assets in a business venture in which the trustee has a personal interest. The terms of the trust cannot, however, waive the duty of the trustee to act in good faith (sec. 5(b)(2) CUTC; sec. 105(b)(2) UTC).

B. Delegation by Trustee (sec. 45a-541i; sec. 807 UTC). This section provides broad discretion in the trustee to delegate fiduciary powers to an agent. If the delegation is done properly, the trustee is not liable to the beneficiaries or the trust for the actions of the agent to whom the function was delegated. While the power to delegate is very important, some settlors may want to limit the scope of possible delegation.

C. Duty to Inform and Report (sec. 66 CUTC; sec. 813 UTC). Otherwise referred to as the "notice provisions," this section has probably produced the most comment and concern. This section establishes rules regarding keeping qualified beneficiaries reasonably informed about trust

administration, responding to requests for information from qualified beneficiaries, notifying qualified beneficiaries of the existence of a trust, providing beneficiaries with annual financial accountings and, upon request, with a copy of the trust agreement. Under the UTC, most of the provisions of section 813 were mandatory. Under the CUTC, however, in the case of inter vivos trusts, most of the mandatory notice rules have been made default rules that can be modified by the terms of the trust. The only rules that are mandatory for inter vivos trusts are: (1) that the qualified beneficiaries who have attained age 21 of a revocable trust that has become irrevocable must be notified of the existence of the trust, the identity of the trustee and their rights, if any, to receive trustee reports; and (2) the duty to respond to the request of a qualified beneficiary of an irrevocable trust for information reasonably related to the administration of the trust. In drafting trust agreements the following will need to be considered:

1. Should a beneficiary have the right to receive a copy of the entire trust agreement, only those portions of the agreement that apply to the beneficiary or nothing?
2. Should the trustee be required to notify all qualified beneficiaries of the creation of an irrevocable trust? This will be especially relevant to trusts created by parents for their children, given the fact that most parents will not want their children to know about the trust until some later date.
3. To whom should the trustee be required to provide financial reports (annual or otherwise) regarding the trust, and what type of financial reports will be acceptable? For example, in the typical credit shelter trust created for the benefit of surviving spouse and children, who should receive regular information regarding the trust? In most cases, Mom and Dad will want the trustee's duties to run to the survivor of them during the survivor's lifetime, but at the same time will want the trustee to be able to help out a child in serious financial need. Since surviving spouse and children are all discretionary beneficiaries, if the trust agreement is silent, the trustee will have a duty to provide regular financial reports to the surviving spouse and the children. Accordingly, if Mom and Dad want the financial reporting limited to the surviving spouse, this needs to be clearly stated in the trust agreement.
4. To whom does the trustee owe fiduciary duties? If the intent is to create a trust with a primary beneficiary to whom the trustee owes its primary duty of loyalty, then this needs to be made very clear in the document. Under the CUTC and at common law, the trustee's duty of loyalty is to all of the beneficiaries, not just the primary beneficiary. Thus, the trustee has the duty to inform all beneficiaries of the existence of the trust and the duty to inquire as to the financial needs of all beneficiaries. If the intent is to have primary and secondary beneficiaries with normal fiduciary duties owed only to the primary beneficiary, the document needs to specifically say so. The typical credit shelter trust for a surviving spouse and a trust for a surviving child (both of which also have additional discretionary beneficiaries) are common examples of trusts that need attention in this regard.
5. Attached to this outline as Exhibit A are examples of how the problems identified above could be handled in a typical credit shelter trust and in a trust for a surviving child.

6. **No Retroactive Effect.** Under the Effective Date rules of CUTC the notification and accounting provisions in subsections (b) and (c) of section 66 do NOT apply to trusts which became irrevocable before the effective date of the Act.

D. **Powers of Trustee** (sec. 68 & 69 CUTC; sec. 815 & 816 UTC). Under the “General Powers” provisions of section 68, a trustee, without court order, may exercise (1) the powers conferred by the terms of the trust; or (2) except as limited by the terms of the trust: (a) all powers over the trust property which an unmarried competent owner has over individually owned property; (b) any other powers appropriate to achieve the proper investment, management, and distribution of the trust property; and (c) any other powers conferred by the Code. In addition, under section 69 of the CUTC the trustee is granted a very comprehensive list of “Specific Powers.” Between the General and Specific Power there is very little that a trustee can’t do. It is likely that some settlors will want to limit the scope of the powers granted to the trustee, especially with respect to exotic investments and lending powers.

E. **Distribution upon Termination** (sec. 70 CUTC; sec. 817 UTC). Under subsection (a), upon the partial or total termination of an inter vivos trust, the trustee may send a proposal for distribution to the beneficiaries. If a beneficiary does not object within 30 days after the proposal was sent, the beneficiary loses his or her right to object and the proposal becomes final. Trust agreements should be reviewed to be sure they do not contain conflicting provisions which negate the benefits of this provision.

II. **General Provisions and Definitions** (secs. 1 - 11 CUTC; Article I UTC)

A. **Governing Law** (sec. 7 CUTC; sec. 107 UTC) and **Principal Place of Administration** (sec. 8 CUTC; sec. 108 UTC). With respect to inter vivos trusts, the CUTC provides broad flexibility in designating the governing law and permitting changes in the principal place of administration of a trust. These provisions should be given careful consideration in trust agreements. For example, in some cases a settlor may want to designate the principal place of administration or require the consent of the beneficiaries to a change in the principal place of administration.

B. **Nonjudicial Settlement Agreements** (sec. 11 CUTC; sec. 111 UTC). With respect to inter vivos trusts, this section provides a broad grant of authority for interested parties to enter into nonjudicial settlement agreements with respect to most matters in connection with administration of the trust (including accountings, construction of the document, the granting of powers to the trustee, resignation or appointment of trustees, trustee compensation, and trustee liability for particular acts). This is a first for Connecticut and should provide great flexibility in dealing with issues that arise from time to time. Drafters may want to include provisions creating procedures for such settlements and specifically approving use of the virtual representation provisions of Connecticut law in such settlements.

III. **Representation** (secs. 16 - 20 CUTC; Article 3 UTC). Virtual representation in trust matters is already the law of Connecticut. However, the existing provisions will be incorporated into the CUTC as envisioned by the drafters of the UTC. While this is the law of Connecticut, drafters should consider including specific provisions in trust agreements directing use of virtual representation in all judicial and nonjudicial matters requiring approval by interested parties.

IV. Modification or Termination of an Irrevocable Trust (secs. 30 -37 CUTC; secs. 410 -417 UTC). These sections provide very broad authority to modify or terminate irrevocable trusts in a variety of circumstances, including unanticipated facts and circumstances, mistakes, cy pres, failed tax objectives, economics, or simply by consent of all parties. Section 31 CUTC (section 411 UTC) deals with judicial and nonjudicial modification or termination by consent and should be carefully considered in the drafting process. If a settlor is living, an irrevocable trust may be modified or terminated without court approval with the consent of the settlor and all beneficiaries. The settlor's power to consent may be exercised by an attorney in fact if authorized in the power of attorney or in the trust; by a conservator with approval of the court supervising the conservator; or by a guardian with approval of the court supervising the guardian. If the settlor is not living, a noncharitable irrevocable trust may be terminated or modified upon consent of all of the beneficiaries if the court concludes that the termination or modification is not inconsistent with a material purpose of the trust and the probable intent of the settlor. In this connection, sec. 5(b)(4) CUTC (sec. 105(b)(4) UTC) provides that the terms of a trust may not override the power of the court to modify or terminate a trust. Drafting issues to consider:

A. If the settlor is living, does the settlor want an attorney in fact, conservator or guardian to have the power to consent to the termination or modification of the settlor's trust? This should be specifically dealt with in the document.

B. If the settlor is not living, the court can only modify or terminate a trust if the court determines that the modification or termination is not inconsistent with a material purpose or intent of the settlor. Accordingly, drafters should consider identifying material purposes and including statements of intent.

C. If the trust contains a spendthrift provision, that provision will not be presumed to be a material purpose. In determining whether the spendthrift provision is material, the court is directed to consider the settlor's intent, and the facts and circumstance surrounding the creation of the trust. The reason for this provision is that spendthrift provisions are routinely buried in the boiler plate portions of the trust agreement and many settlors are not even aware of their existence. Accordingly, drafters need to focus on this and indicate whether a spendthrift provision is intended to be a material purpose. One way to make the intent clearer would be to include the spendthrift provision in with the dispositive provisions of the trust, making it more likely that the settlor read and approved of the provision.

V. Creditor's Claims; Spendthrift and Discretionary Trusts (secs. 38 - 44 CUTC; Article 5 UTC).

A. **Spendthrift Provision** (secs. 39 & 40 CUTC; secs. 502 & 503 UTC). Under current Connecticut law, a spendthrift provision will not protect a beneficiary's interest from attachment by creditors. The only way under current law to get spendthrift-type protection is for the trust to be designed as a "support" trust or designed as a totally "discretionary" trust. This provision changes Connecticut law and specifically approves the use of traditional spendthrift language. If the terms of the trust contain spendthrift language, then a creditor may not reach the beneficiary's interest or a distribution by the trustee before its receipt by the beneficiary. Drafters may now want to consider including spendthrift language in their trust documents, especially in special needs trusts. Drafters need to take note that there are exceptions for court orders of support for a beneficiary's child,

spouse or former spouse. The “effect” of a spendthrift provision is one of the “mandatory” provisions under section 5 of the CUTC.

B. Discretionary Trusts; Effect of Standard (sec. 41 CUTC; sec. 504 UTC). This section provides that whether or not the trust contains a spendthrift provision, a creditor of a beneficiary may not compel a distribution that is subject to the trustee’s discretion, even if (1) the discretion is expressed in the form of a standard of distribution; or (2) the trustee has abused the discretion. This provides tremendous creditor protection for discretionary trusts and should be a real incentive for drafters to use discretionary trusts. Note, however, that if the trustee has failed to comply with a standard of distribution or has abused a discretion, this section also contains an exception for a child, spouse or former spouse with a court order of support.

C. Creditor’s Claim Against Settlor (sec. 42 CUTC; sec. 505 UTC). This section provides as follows regarding claims against a settlor: (1) During a settlor’s lifetime the property in a revocable trust is subject to claims of the settlor’s creditors. (2) With respect to an irrevocable trust, a creditor may reach the maximum amount that can be distributed to or for the settlor’s benefit. (3) After a settlor’s death, except as otherwise provided in section 45a-472, the property of a trust that was revocable at the settlor’s death is subject to claims of the settlor’s creditors to the extent the settlor’s probate estate is inadequate to cover such claims. Given the uncertainty that exists under current Connecticut law regarding the liability of a revocable trust for claims against a deceased settlor, documents may need to be revised to reflect the fact that under the CUTC such trusts are liable for claims of the settlor’s creditors.

VI. Revocation or Amendment of Revocable Trust (sec. 46 CUTC; sec. 602 UTC). This section provides that a revocable trust may be amended or revoked by complying with the method set forth in the trust, or, if the trust is silent or the method is not made exclusive (1) by a later Will admitted to probate that refers to the trust or specifically disposes of property that otherwise would have passed under the trust, or (2) any other method manifesting clear and convincing evidence of the settlor’s intent; provided that a written revocable trust may only be amended by a later written instrument and may only be revoked by a later written instrument or by destruction. The settlor’s power to amend or revoke may be exercised by (1) an attorney in fact if authorized by the power of attorney of the terms of the trust, or (2) by a conservator with court approval unless expressly prohibited by the terms of the trust. Drafters need to consider carefully and provide in the trust agreement the manner in which a revocable trust can be amended or revoked and whether the power should be exercisable by an attorney in fact or a conservator.

VII. Miscellaneous Considerations.

A. Section 51 CUTC (sec. 703 UTC) provides that trustees may act by majority vote. This changes current Connecticut default law which requires unanimous vote.

B. Under Section 53 CUTC (sec. 705 UTC) a trustee may resign without court approval on 30 days advance notice. Drafters may want to revise trust provisions to be consistent.

C. Section 77 CUTC (sec. 1008 UTC) imposes limitations on the enforceability of an exculpation provision. Drafters who wish to include exculpatory language should consider how any such provision needs to be drafted and communicated to the settlor.

EXHIBIT A

I. Credit Shelter Trust with primary and secondary beneficiaries and waiver of fiduciary duties to secondary beneficiaries.

Article II. Estate Tax Sheltered Trust. If my Trustees receive property to be held in the Estate Tax Sheltered Trust and administered in accordance with this Article, then my Trustees shall administer such trust as follows:

A. My Trustees shall pay or apply all or any part of the net income and principal from the Estate Tax Sheltered Trust to or for the benefit of my wife, in such amounts and proportions and in such manner, as my Trustees in their discretion consider advisable for her maintenance in health and reasonable comfort, or support in her accustomed manner of living. In addition to the foregoing powers, except as limited by section B, my Independent Trustees may from time to time pay or apply all or any part of the net income and principal to or for the benefit of any one or more of my wife and descendants living from time to time, in such amounts and proportions and in such manner, equal or unequal or all to one person, as my Independent Trustees in their sole discretion consider advisable, with no duty to equalize such payments among eligible beneficiaries. Any undistributed income shall be added to trust principal.

B. It is my intent that my wife shall be the primary beneficiary of this trust. In exercising their discretion in distributing trust funds, my Trustees shall give primary consideration to the needs of my wife and shall not make distributions to or for the benefit of my descendants unless my Independent Trustees determine that there should be sufficient trust property remaining to provide for my wife during her lifetime. With respect to all eligible beneficiaries other than my wife, my Trustees shall not have the fiduciary duty to (i) notify such eligible beneficiaries of the existence of the trust, (ii) inquire into the financial needs of such eligible beneficiaries, (iii) provide such eligible beneficiaries with a copy of the trust instrument, nor (iv) provide such eligible beneficiaries with financial information regarding the trust.

II. Trust for surviving child with primary and secondary beneficiaries and waiver of fiduciary duties to secondary beneficiaries.

Article IV. Trusts for Descendants. Any property directed to be held in trust and administered pursuant to this article shall be disposed of as follows:

A. My Trustees shall hold the share of each descendant of mine (hereinafter referred to as the "Beneficiary") in a separate trust and shall pay or apply all or any part of the net income and principal therefrom to or for the benefit of the Beneficiary, in such amounts and proportions and in such manner, as my Trustees in their discretion consider advisable for such Beneficiary's maintenance in health and reasonable comfort, complete education (including preparatory, college, postgraduate and professional training), or support in such Beneficiary's accustomed manner of living. In addition to the foregoing powers, except as limited by section B, my

Independent Trustees may from time to time pay or apply all or any part of the net income and principal to or for the benefit of any one or more of the Beneficiary and the Beneficiary's descendants living from time to time, in such amounts and proportions and in such manner, equal or unequal or all to one person, as my Independent Trustees in their sole discretion consider advisable, with no duty to equalize such payments among eligible beneficiaries. Any undistributed income shall be added to trust principal.

B. The Beneficiary shall be the primary beneficiary of this trust. In exercising their discretion in distributing trust funds, my Trustees shall give primary consideration to the needs of the Beneficiary and shall not make distributions to or for the benefit of the Beneficiary's descendants unless my Independent Trustees determine that there should be sufficient trust property remaining to provide adequately for the Beneficiary. With respect to all eligible beneficiaries other than the Beneficiary, my Trustees shall not have the fiduciary duty to (i) notify such eligible beneficiaries of the existence of the trust, (ii) inquire into the financial needs of such eligible beneficiaries, (iii) provide such eligible beneficiaries with a copy of the trust instrument, nor (iv) provide such eligible beneficiaries with financial information regarding the trust.

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