

**SOME HIGHLIGHTS OF
DELAWARE TRUST LITIGATION IN 2017
AND
DELAWARE TRUST LEGISLATION IN 2017**

**Presented at the
Delaware 2017 Trust Conference**

October 24 and 25, 2017

By Norris P. Wright, Esquire

GF&M GORDON, FOURNARIS
& MAMMARELLA, P.A.

1925 1925 Lovering Avenue
Wilmington, DE 19806

nwright@gfmlaw.com

(302) 652-2900

Delaware Trust Litigation in 2017

There were not many cases related to trusts and fiduciaries by the Delaware Courts in 2017. The most significant case is Mennen, about which I have reproduced, with some edits, our firm's fiduciary litigation blog, which can be found on our firm's website at www.gfmlaw.com. Most of the other cases were not relatively significant in terms of the factual background or the issued opinions.

There were a series of opinions issued in the Mennen case, including a draft report and a final report by Master LeGrow of the Delaware Chancery Court, a dismissal of a motion for summary judgment, an order by Vice Chancellor Laster and a one-page affirmation of the Master's final report by the Delaware Supreme Court. I will go through these blogs in chronological order.

I will then discuss some of the significant "take-aways" from the Mennen case.

Kathryn Mennen, et al. v. Wilmington Trust Company, a Delaware corporation,
C.A. No. 8432-ML

(January 17, 2014)

The plaintiffs in this case, who are the beneficiaries of a trust, are seeking the removal of the co-trustees and damages in excess of \$100 million as a result of alleged breaches of the co-trustees' fiduciary duties. The defendant trustees include an individual who has a separate trust created for his benefit. If the plaintiffs succeed in their claims against the individual trustee of the trust, they may be entitled to tens of millions of dollars in damages that the individual trustee likely will not be able to pay. Hence, if they are awarded damages, Plaintiffs seek to pierce the individual trustee's separate trust, but that has a spendthrift clause. The grantor created four trusts: one for each of his four children and their issue; the defendant individual co-trustee is one of the grantor's children.

In addition to arguing that summary judgment on this issue was not ripe because there remained disputed issues in fact, plaintiffs disputed the enforceability of the spendthrift provision against them, arguing first that they are not potential creditors under the trust's terms or 12 Del. C. § 3536, and second that, even if they are potential creditors, they may pierce the spendthrift trust because (1) public policy precludes enforcing a spendthrift trust against tort claimants of the plaintiffs' variety, or (2) the trusts at issue are essentially sub-trusts, and the Plaintiffs are entitled to impound trustee's interest in his separate trust.

The Master rejected all those arguments. In so doing, she noted that, "[a]lthough the policy arguments against enforcement of spendthrift clauses are interesting and compelling, the passage of Section 3536 made clear that this Court must enforce such clauses, subject only to the limits contained or permitted in the statute." She went on to note that while spendthrift clauses are not "entirely unassailable," Plaintiffs' arguments for an exception under these facts are unavailing. Specifically, the Master concluded that if Plaintiffs were successful at trial, they would merely become creditors of the individual trustee within the meaning of Section 3536. The Plaintiffs argued that as tort claimants and family members they should be entitled to pierce the trust. But the Master explained that there is ample precedent that tort claimants are creditors within the meaning of Section 3536. And as far as being family members, the Master noted that

the claims at issue were not “support obligations” or the like, but instead traditional fiduciary breach allegations.

The Master further explained that Delaware law does not recognize an exception to spendthrift clauses for beneficiaries who engage in repeated acts of wrongdoing. And the Master found that impoundment also isn’t applicable as the trusts at issue are separate trusts and Plaintiffs’ impoundment theory would violate Section 3536 (and in any event, would be “legally impossible” because there was no identifiable share in the separate trust). For all those reasons, the Master recommended granting the individual trustee’s motion for summary judgment.

Kathryn Mennen, et al. v. Wilmington Trust Company, et al. C.A. No. 8432- ML
(December 8, 2014)

This is the summary of the draft report issued by Master LeGrow after a trial on whether the individual co-trustee of a family trust breached his fiduciary duties to the beneficiaries by his poor investments that, the beneficiaries alleged, were made in bad faith.

The plaintiffs/beneficiaries in this case petitioned for removal of the co-trustees of the trust and sought damages in excess of \$100 million as a result of alleged breaches of the co-trustees’ fiduciary duties. The defendant trustees included an individual who has a separate trust created for his benefit. The grantor created four trusts: one for each of his four children and their issue; the defendant individual co-trustee is one of the grantor’s children. The other defendant co-trustee, Wilmington Trust Company, settled with the beneficiaries on the eve of trial and was dismissed from the case.

The trust was once valued at over \$100 million and was reduced to roughly \$25 million through a series of debt and equity investments at the direction of the individual co-trustee. The question before the court was whether- without Monday-morning quarterbacking- the challenged transactions exposed the trustee to liability. In other words, could the beneficiaries collect their sought-after damages from the Delaware spendthrift trust?

The trust agreement modified the trustee’s default duties and exculpated the trustees from liability unless they acted in bad faith or with willful misconduct. The Court concluded that the

trustee had engaged in non-exculpated breaches of trust with regards to the vast majority of the transactions at issue. And perhaps most notably, the Court found that the bulk of the transactions made in bad faith were not the result of the trustee seeking to gain immediate pecuniary benefit for himself, but rather most of the challenged transactions were motivated by the trustee's pride. This was because, according to the Court, the trustee's personal fortune was not accessible to him, as it was locked in his own trust, and so, the trustee turned to his brother's trust and treated it as if it was his own back account where he could readily withdraw funds to fund a few private companies in which he had a stake in and were what he thought would be the "next big thing." The Court held that the trustee willfully ignored his duties to the beneficiaries so that he could, in the Court's words, subsidize his "self-aggrandizing standing as a financier."

There was no question that the transactions were bad investments. The issue before the Court was whether the trustee made the transactions in bad faith. Unsuccessfully, the trustee argued that the question of whether he failed to act in good faith should be determined by the subjective standard. The Court found that there was no precedent for this and applied the objective, reasonable judgment standard. The Court also found the trustee's equitable defenses of laches and acquiescence unavailing. As a result of the Court's factual findings and findings of law, the Court concluded that the beneficiaries were entitled to damages in the amount of \$72,448,299.93.

Kathryn Mennen, et al. v. Wilmington Trust Company, et al. C.A. No. 8432

(Motion of Summary Judgment)

(April 24, 2015)

On January 17, 2014, the Master in Chancery issued a draft report denying the beneficiaries' motion for summary judgment and concluding that the court could not pierce the spendthrift clause of the co-defendant trustee's separate trust due to the trustee's repeated wrongdoings. In the interest of efficiency, and in recognition that the parties would be engaged in trial soon after the issuing of the draft report, the Master stayed the time period to take exceptions to the draft report until she issued a draft post-trial report resolving the beneficiaries' claims against the co-trustees.

On April 24, 2015 the Master in Chancery issued her Final Report, adopting her ruling in her Draft Report. Save for a few non-substantive changes, the Final Report is nearly identical to the Draft Report.

Kathryn Mennen, et al. v. Fiduciary Trust International of Delaware, et al.
No. 1, 2016

(October 11, 2016)

On the basis that the exceptions to the Master's report were late-filed, the Vice Chancellor granted a motion to strike the exceptions to the Master's final report. The Master's final report found that, among other things, the beneficiaries of a trust could not pierce the co-trustee's own spendthrift trust to collect on a large damages award against the co-trustee for fiduciary breaches. The Supreme Court reversed the Vice Chancellor's decision to not hear the exceptions on procedural grounds. As a result, the Vice Chancellor seemingly will now decide on remand whether the Master's substantive decision finding that the co-trustee's trust was protected was correct on the merits.

Mennen, et al. v. Wilmington Trust Co., et al. CA No. 8432-VCL

(February 27, 2017)

In the Delaware Court of Chancery, there is a procedure for Vice Chancellors to review Master's reports if "exceptions" are taken by one or both of the parties. That review occurs de novo. After some procedural back and forth between Chancery and Supreme Court in the present case, Vice Chancellor Laster issued a February 27, 2017 report completely and wholly adopting the April 24, 2015 final report as written.

Mennen, et al. v. Fiduciary Trust International of Delaware, et al.

(May 17, 2017)

In a nationally significant one-page order, the Delaware Supreme Court affirmed the Court of Chancery's February 27, 2017 order, which was based on the "well-reasoned" April 24, 2015 Master's Final Report.

What Are The Important “Take-Aways” From The Mennen Case?

A. Standard Liability Of A “Directing Trustee” Who Is Clothed With Basically All Investment Powers.

1. Although this Trust Agreement did not address specifically the standards of gross negligence or willful misconduct, the Court did discuss these standards in the context of whether a “directing trustee” could be excused from either of these standards. The Court found that the 2003 Trust Act passed by the Delaware General Assembly clearly provides that a standard of liability in a trust instrument may not excuse willful misconduct, no matter when the trust was created.
 - a. Coupled with the stated relief from liability of the “directing fiduciary” so long as he acts in good faith, this leaves the standard of liability of the “directing trustee,” in this case, as the absence of willful misconduct or bad faith (the Court considered the term “bad faith” as the lack of good faith).
 - b. The Court also stated that even if a trust agreement permits a fiduciary to engage in transactions that might otherwise be prohibited (such as the duty to diversify investments or the duty to avoid conflicts of interest), as here, the fiduciary is still subject to the duty of loyalty to the beneficiaries and must not act in bad faith or unfairly.
 - c. This is significant in that it may be read to apply generally to advisors, such as Investment Direction Advisors, and the standard of care to which they must adhere, unless the trust agreement specifically relieves them from any liability for their actions except willful misconduct.

B. Trustee’s Actions Tested Twice. The Court confirms that a trustee’s actions are “twice-tested” under Delaware law. First, the Court will look at the governing instrument or Delaware law to see if the trustee that was empowered to act in a certain manner. Next, the Court will then consider whether such action, even if permitted by law, was a breach of the trustee’s fiduciary obligations.

1. The Court went on to state that where the trustee’s action is granted in the governing instrument along with an exculpatory clause, the trustee is protected so long as the exculpatory clause is enforceable;
2. The Court then noted that (i) Delaware’s Trust law precludes the exculpation of a trustee’s actions taken with willful misconduct; and (ii) the governing instrument, in this particular case, requires that the trustee act in good faith.

C. Spendthrift Clause Enforced.

1. The Court was asked to allow the Plaintiffs to recover their awarded damages against the “directing fiduciary’s” Trust share, even though that Trust share was subject to a spendthrift clause exempting it from any execution, attachment or other legal process by any creditor or assignee of a beneficiary.
 - a. The Plaintiffs argued that (i) the spendthrift clause should not be applied to these Plaintiffs, or (ii) the Court should create an exception to allow the spendthrift clause to be pierced, similar to what was done with respect to a support obligation owed to a wife by a husband in a prior case.
2. The Court stated that tort claimants may not reach the assets in a spendthrift trust, denying their argument that the circumstances of this case (a fiduciary matter) involving a family member should make the Plaintiffs a special type of creditor not falling within the definition of a “creditor.”
 - a. The Court stated that neither the statute (12 Del. C. § 3536) nor precedent permitted special treatment of the Plaintiffs;
 - b. The Court found the exception of a husband’s support obligation to a former spouse as not being an actual debt not applicable in this case.

D. Laches and Virtual Representation.

1. The Court, noted that it frequently referred to the statute of limitations set forth in 12 Del. C. § 3585 in determining if a Plaintiffs’ claims are barred by laches; i.e., plaintiffs delayed bringing claims unreasonably.
 - a. 12 Del. C. § 3585 bars a claim upon the first to occur of (i) two (2) years after the Plaintiffs received a report that adequately disclosed that facts constituting the claim, or (ii) the date the claims were otherwise precluded by limitation, which, Plaintiffs argued was three (3) years in this case;
 - b. Although the Plaintiffs concede that the investments by the “directing trustee” occurred more than three (3) years before they filed their actions, they argued that the statute of limitations was tolled by the “directing trustee’s” fraudulent concealment of the problems with the trust. The Court did not buy that argument, finding that the Plaintiffs were on “inquiry notice,” meaning a person of reasonable intelligence would have questioned matters that appeared in the reports they received.

2. The Court then found that the Plaintiffs, being the minor children of the income beneficiary, would not be barred by laches unless the Court found that their father virtually represented them under 12 Del. C. § 3547.
 - a. The Court stated that the virtual representation statute unambiguously limits virtual limitation to situations where there is no material conflict of interest between those being virtually represented and the one representing them.
 - b. Here the Court found that there was a material conflict since the Plaintiffs' father only cared about receiving his monthly distribution from the Trust, ignoring and not questioning the underlying investments.

Some Highlights of Trust Act 2017

A. Excluded Trustee. New § 3313A of Title 12 of the Delaware Code.

1. A trustee who is subject to direction from a co-trustee must act in accordance with the direction and shall not have any liability for any loss resulting from compliance with such direction, unless such compliance constitutes willful misconduct on the part of the directed trustee; and a directed trustee has no duty to monitor the actions or decisions of the directing co-trustee, etc.
 - (a) This new statute provides protections to a directed trustee similar to those afforded to a trustee under 12 Del. C. § 3313 with respect to advisors;
 - (b) Previously many practitioners would refer to § 3313 when drafting to explain the relationship between a co-trustee who is granted sole power with respect to certain trustee powers and the co-trustee who is excluded from exercising such powers. This new § 3313A is intended to make such drafting not only a bit easier, but also establishes a statutory basis for doing so.

B. Limitation of Action Against Trustee Following Trustee's Report. New § 3585 of Title of the Delaware Code.

1. Added new subsection (a)(2) which provides another limitation period (see below).
2. Added new subsection (c)(3) regarding notice to a Designated Representative.

“§ 3585 Limitation of action against trustee following trustee's report.

 - (a) A beneficiary may initiate a proceeding against a trustee for breach of trust until the first to occur of:
 - (1) Two years after the date the beneficiary was sent a report that adequately disclosed the facts constituting a claim; or
 - (2) In the case of any trustee who has resigned, been removed or ceased to serve as trustee for any other reason (including, but not limited to, on account of the termination of the trust by reason of liquidation or by reason of a merger or similar transaction described in § 3341 of this title), one hundred twenty days (120) after the date the beneficiary was sent a report that (i) notifies the beneficiary that the trustee has ceased to serve; (ii) adequately discloses the facts constituting a claim;

and (iii) adequately discloses the time allowed under this section for initiating proceedings against the former trustee; or

- (3) The date the proceeding was otherwise precluded by adjudication, release, consent or limitation or pursuant to the terms of the governing instrument.
 - (b) A report adequately discloses the facts constituting a claim if it provides sufficient information so that the beneficiary knows of the claim or reasonably should have inquired into its existence.
 - (c) For the purpose of subsection (a) of this section, a beneficiary is deemed to have been sent a report if:
 - (1) In the case of a beneficiary having capacity, it is sent to the beneficiary; or
 - (2) In the case of a beneficiary who under § 3547 of this title may be represented and bound by another person, it is sent to the other person; or
 - (3) In the case of a beneficiary who under subsection (d) of § 3303 of this title is represented and bound by a designated representative, it is sent to the designated representative.
 - (d) If subsection (a) of this section does not apply, a judicial proceeding by a beneficiary against a trustee for breach of trust must be commenced within 5 years after the first to occur of:
 - (1) The removal, resignation, or death of the trustee;
 - (2) The termination of the beneficiary's interest in the trust; or
 - (3) The termination of the trust.
 - (e) This section does not preclude an action to recover for fraud or misrepresentation related to the report.”
3. It had been the practice in Delaware that Chancery Court would not issue a res judicata order approving a trustee's accounting filed with the Court if no, or only some, beneficiaries appeared. This meant there was no satisfactory way for a trustee to be released without obtaining a written release from the appropriate beneficiaries.
4. Now there is a statutory roadmap for a trustee to follow.