

**Delaware Trust Conference  
Delaware Trusts: Built to Last  
Tuesday, October 22, 2019  
2:00 pm – 3:00pm**

**Construction of a Trust (Practical vs Reality)**

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## Case Study #1 – Inconsistent standards of liability

A Delaware corporation is serving as the sole Trustee of a trust administered in Delaware. The Trust is an irrevocable trust, held for the benefit of the Settlor's issue in perpetuity (i.e., a "Dynasty Trust"). The Settlor is from a modestly wealthy family, but he is poised to become a successful entrepreneur in his own right after leveraging the funds received from his family. The Trust holds a portfolio of marketable securities with a significant concentration in a few securities which have historically been owned by the family and which have a very low basis, as well as interests in a closely held family business. The marketable securities currently account for the majority of the value of the trust fund, but the Settlor believes the family business interests will appreciate rapidly and will eventually become the major holding of the Trust. The Trust Agreement provides for a "Special Holdings Distribution Advisor" to direct the Trustee with respect to any and all actions involving the family business interests.

After a series of meetings with the corporate Trustee, the Settlor, the adult issue of the Settlor, and the Special Holdings Distribution Advisor, a decision was made to begin to diversify the marketable securities portfolio. The first step agreed upon at the latest meeting was to sell a portion of one of the marketable securities, especially in light of recent uncertainties regarding the future of the company. Since the investment decision was not related to the family business interests, no direction from the Special Holdings Distribution Advisor was required for the corporate Trustee to initiate the transaction. The sell order was not processed by the corporate Trustee until three business days after the meeting. On the same day the trade was submitted, the company which issued the securities made a public announcement which caused the stock price to drop precipitously. Had the trade been processed the day prior, the Trust would have avoided a significant loss in its portfolio. The corporate Trustee is examining what caused the delay in placing the trade, and it is unclear whether it was due to a lack of communication from the family or an issue within the offices of the corporate Trustee. While awaiting this determination, the corporate Trustee's legal department has begun examining its potential exposure. Counsel has identified a potential issue with the language of the trust, and the standard of liability applicable to the Trustee. Counsel believes that a gross negligence standard will apply in examining the actions of the Trustee, and not willful misconduct. When the Trustee was initially approached with serving as Trustee, it was contemplated that only the family business interests would be held in the Trust, and that the corporate Trustee would serve in a more limited capacity as a Delaware administrative trustee. Over time, however, the plans changed and it was decided to move to a new structure with a Special Holdings Distribution Advisor and to add a portfolio of securities to the Trust. The relevant provisions of the final Trust Agreement are as follows:

### "Trustees and Advisors

6. As provided under Delaware law, in no event shall any Administrative Trustee hereunder be liable for any matter with respect to which such Trustee is directed pursuant to the provisions of this Agreement unless the Administrative

Trustee has acted with willful misconduct; provided, however, that the foregoing sentence shall not apply to the Administrative Trustee's exclusive duties set forth herein which shall be carried out in the sole discretion of the Administrative Trustee. Notwithstanding the foregoing, a bank or trust company may serve simultaneously as both a Trustee and Administrative Trustee for any trust hereunder.

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Trust Administration Provisions

D. No Trustee shall be liable for any loss or damage to the trust fund, unless such loss or damage was caused by the willful misconduct or gross negligence of such Trustee.”

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The problem presented here – conflicting trust provisions with respect to the standard of liability applicable to a Trustee when acting at the direction of an advisor or without being subject to direction – could be addressed by providing a single liability standard in the trust document, rather than having multiple provisions that address liability. A sample provision might provide:

“Trust Administration Provisions

A. Whenever Trustee acts or fails to act at the direction of any person authorized, pursuant to the terms of this Agreement, to direct Trustee in the exercise of Trustee's powers, then notwithstanding any other provision of this Agreement or otherwise existing provision of law or in equity, (i) as provided in 12 Del. C. § 3313, Trustee shall not be liable for any loss resulting from such acts except in cases of willful misconduct, and (ii) to the extent any such action concerns a matter outside the scope of 12 Del. C. § 3313, in accordance with 12 Del. C. § 3303, Trustee shall have no liability under this Agreement except for Trustee's own willful misconduct.”

## Case Study #2 – A Troublesome Silent Trust provision

A Delaware corporation is administering a trust for the benefit of certain specified grandchildren of the Settlor. The Settlor's counsel indicated that the trust was intended to be the recipient of annual exclusion gifts from the Settlor. The Trustee has complete discretion to distribute the income and principal of the trust fund to the grandchildren of the Settlor until the youngest of such grandchildren attains the age of sixty-five, but only for the purpose of providing for the catastrophic health needs of a grandchild that are not otherwise eligible for payment under any private or governmental insurance program. Upon the youngest grandchild attaining the age of sixty-five, the trust will terminate and be distributed outright in equal shares to such of the Settlor's grandchildren as are then living.

The Settlor's counsel further indicated that the Settlor's intent was to provide a source of retirement funds for her grandchildren. However, she was concerned that her grandchildren's motivation to also take responsibility and save for their retirements could be diminished if they knew about the Trust. Therefore, a "silent trust" provision was included in the trust. The Settlor has made her first contributions to the trust in an amount equal to the maximum amount eligible for the gift tax annual exclusion for gifts to all of her grandchildren who are beneficiaries of the Trust. The trust officer assigned to the relationship notes that "Crummey" withdrawal notices will need to be provided to each of the grandchildren. Upon reviewing the Trust Agreement, the trust officer realizes that the Trustee is prohibited from providing any information concerning the trust to the beneficiaries prior to their attaining the age of sixty-five. Therefore, he is unsure as to how the withdrawal notices can be provided to the beneficiary as required by the terms of the trust. The relevant provision of the Trust Agreement are as follows:

### "Withdrawal Powers

#### Notice to Withdrawal Beneficiaries

Upon the receipt of any contribution of cash or other property which is transferred to Trustee to be held as part of the trust fund during any calendar year (a "Contribution"), Trustee shall give notice of such Contribution as soon as reasonably practical to each of the Grandchildren of Trustor living from time to time (for purposes of this Section, individually, a "Withdrawal Beneficiary" and, collectively, the "Withdrawal Beneficiaries"). If any Withdrawal Beneficiary is a minor or is under a disability at the time of such Contribution, Trustee shall give said notice to his or her guardian, conservator or, if none, to his or her parent or such other person or institution in a position legally to act on his or her behalf as Trustee shall deem appropriate (the "Notice Designee"). Each notice shall set forth the

nature and extent of said Withdrawal Beneficiary's power of withdrawal with respect to such Contribution and the procedures for exercising the same.

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Trust Administration Provisions

A. Notwithstanding any other provision of this Agreement and in accordance with 12 Del. C. § 3303(a), the Trustee and any other Adviser serving in accordance with the provisions of this Agreement shall not furnish any account statement to any beneficiary of the Trust or provide any such beneficiary of notice of the existence of the Trust until such beneficiary attains the age of sixty-five (65).”

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The problem presented here – conflicting trust provisions with respect to the information the Trustee is required to provide the beneficiary – could be addressed by providing a designated representative who can receive the withdrawal notices on behalf of the beneficiaries. A sample provision might provide:

“Trust Administration Provisions

A. Notwithstanding any other provision of this Agreement and in accordance with 12 Del. C. § 3303(a), the Trustee and any other Adviser serving in accordance with the provisions of this Agreement shall not furnish any account statement to any beneficiary of the Trust or provide any such beneficiary of notice of the existence of the Trust until such beneficiary attains the age of sixty-five (65).

B. During such time or times as the Trustee and any other Adviser are, by the terms of this Agreement, not permitted to provide notice of the existence of the trust or furnish trust information to a beneficiary or beneficiaries hereunder, the applicable Trustee or Adviser shall furnish any trust information permitted or required to be provided to a beneficiary under the terms of this Agreement, to the Designated Representative (as defined

below), who shall be considered a designated representative within the meaning of 12 Del. C. § 3339. By delivery of said trust information to the Designated Representative, the applicable Trustee or Adviser will be deemed to have satisfied its duties relating to the provision of such information and shall have no liability for the failure to provide such information to the beneficiary or beneficiaries or for the actions and/or omissions of the Designated Representative. The Designated Representative shall have the authority to acknowledge receipt of any trust information provided to such person.”

### Case Study #3 – Discretionary Distributions

A Delaware corporate Trustee is administering a large trust where the beneficiary has significant lifestyle expenses. The Settlor included in the document a number of provisions to guide the Trustee in making discretionary decisions for the beneficiary, but the language meant to be a guide hasn't always been helpful. The beneficiary of the trust lives in a community property state and recently married, without creating a prenuptial agreement. Prior to the current corporate Trustee's service, the initial Trustee exclusively made outright distributions of trust property to satisfy the beneficiary's requests, which are frequent. The provisions of the Trust Agreement concerning the Trustee's discretion to make distributions of principal and income are potentially at odds with one another. Certain provisions of the Trust Agreement, along with related comments, are as follows:

“A. The Settlor has created the trust held pursuant to the provisions hereof in order to provide for the beneficiaries hereof while simultaneously protecting the assets hereof from claims of their creditors, including spousal claims.

B. Trustee is encouraged to refrain from making distributions of trust assets to the beneficiaries, but rather to provide the beneficiaries hereof with the liberal “use” and “enjoyment” of the trust property.

C. The Settlor intends that to the extent a beneficiary's own assets are adequate for his or her support, such beneficiary should generally be required to provide for his or her own living expenses. The foregoing is to guide the Trustee only and, notwithstanding such guidance, the discretion of the Trustee is absolute.

D. It is Settlor's objective in creating this trust to provide liberally for the personal and financial welfare of the beneficiaries. Notwithstanding the foregoing, the Settlor desires that the Trustee should not permit a beneficiary to become so financially dependent upon the trust created hereunder that he or she loses the incentive to become a productive member of society in a manner that is reasonably commensurate with the ability and circumstances of such beneficiary.

E. In determining whether to make discretionary distributions of net income or principal to a beneficiary, the Trustee may but need not consider such circumstances and factors as the Trustee believes are relevant, including the other income and assets known to the Trustee to be available to that beneficiary and the advisability of supplementing such income or assets, and the tax consequences of any such distribution.”

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The problem presented here – conflicting and amorphous trust provisions with respect to the standards applicable to the Trustee exercising discretionary distribution authority – could be addressed by providing for a Settlor “Statement of Wishes” to serve as a guide to the Trustee in exercising its discretion, without requiring that it do so. A sample provision might provide:

“A. Settlor may, from time to time, provide a Statement of Wishes to the Trustee. Such Statement of Wishes is intended to serve as guidance to the Trustee in directing the distribution of income and principal hereunder, and Settlor requests that the Trustee consider any guidance set forth therein. This provision for a Statement of Wishes is not intended to alter any standard otherwise applicable to distributions of income or principal hereunder, or to alter the absolute discretion of the Trustee in exercising its discretion to direct that any distributions hereunder be made or omitted.”



Case Study #4 – Trustee Resignation: How Do We Get Out of This?

A Delaware trust company is administering a trust established by a business executive. The trust was funded with non-marketable securities below the bank's standard minimum account value, and charged a reduced fee as the first step in what was expected to become a larger and more profitable relationship. Before this happened, the Settlor was arrested and later admitted to having committed various crimes. The corporate Trustee has made the decision to exit the relationship, but has struggled to accomplish this.

Given negative news around the Settlor, it is not likely any other Delaware corporate Trustee would be willing to step in as successor. The current Trustee has the power to resign. The Settlor can appoint a trust protector, who in turn has the power to name a successor Trustee. After his legal troubles, the Settlor has stopped communicating with the corporate Trustee. He refused to name a trust protector or identify a willing successor Trustee. The relevant provision of the Trust Agreement are as follows:

“B. Any Trustee hereunder may at any time resign his, her or its office as Trustee by written instrument in writing, duly signed and acknowledged and delivered to his, her or its co-Trustees, if any, and to the successor Trustee, if any, designated to succeed him, her or it, or if none to the Settlor.

C. The Settlor reserves the right to appoint, for any trust hereunder, an individual or entity to serve as Trust Protector, provided that such individual or entity is not a ‘related or subordinate party’ with respect to the Settlor within the meaning of Section 672(c) of the Code.

D. The Trust Protector shall have the right to appoint an individual or corporation with fiduciary powers to replace a removed Trustee, or whenever the office of Trustee of a trust becomes vacant.”

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The problem presented here – a trust that permits resignation but lacks an enforceable mechanism for the appointment of a successor – could be addressed by providing for the beneficiaries to have the obligation to appoint a successor and granting the Trustee the clear power to request the Court to appoint a successor. A sample provision might provide:

“D. If at any time after during the continuance of any trust hereunder, there is no Trustee serving hereunder and no successor Trustee has been appointed by the Trust Protector, then within thirty (30) days of the vacancy, a majority of the beneficiaries to whom the Trustee of such trust is then authorized to make current income distributions, who are legally competent, shall appoint a successor Trustee in a written notice delivered to the existing Trustee.

E. In the event that a successor Trustee is not appointed in accordance with any of the above provisions within a reasonable time after the resignation or removal of the last serving Trustee, such Trustee may file an appropriate petition with the Delaware Court of Chancery or such other court as may have jurisdiction over the administration of the trust seeking an appointment of a successor Trustee and/or depositing the trust property with the court. All costs and expenses, including reasonable attorneys’ fees, for any such proceeding shall be a proper expense of the trust.”

## Case Study #5 – Issues with Litigation Expenses

A Delaware corporation is serving as the corporate Co-Trustee of a Delaware trust. The Trust was originally an irrevocable trust which was created for the benefit of the grandchildren of the Settlor. Upon the death of the Settlor, the trust split into separate trusts, each for the benefit of a single grandchild. The Trustees continue to administer the separate trusts. The Trustees do not exercise any powers at the direction of an advisor, and have full authority for all distribution and investment decisions. The Trustees have complete discretion to make distributions of income and principal to the beneficiary in the Trustees' complete discretion. The Trustees are only liable for actions which constitute willful misconduct. An individual, who was a trusted advisor to the Settlor, serves as Co-Trustee with the corporation.

When creating the trust, the Settlor was keenly aware that several members of the family had substance abuse issues. Therefore, the Settlor included in the trust a Statement of Intent which stated that in making any discretionary distribution of income or principal, the Trustee should consider Settlor's wish, but not direction, that no distribution be made to any beneficiary who had any involvement with alcohol or any illicit drugs, including but not limited to the use, abuse or sale of any such substances.

One of the Settlor's grandchildren requested that the Trustees make a large distribution to him to fund his new business venture, a medical marijuana dispensary. This beneficiary had been denied distributions in the past due to his own substance abuse issues, but had recently completed a rehabilitation program. The Co-Trustees determined that they would not make the distribution to the beneficiary, in part due to the express intent of the Settlor not to make distributions to any beneficiary involved with illicit drugs. The beneficiary has since filed suit against both Trustees for breach of fiduciary duty in refusing to make the distribution. He has alleged that the Trustees have no basis for denying the distribution when a medical marijuana dispensary is a legal enterprise in his state of residence. He has further alleged that the Trustees are seeking to punish him for his past behavior in refusing the distribution request. The beneficiary has hired a team with a reputation for being aggressive litigators. He has further made it known that the firm agreed to take the case on a contingent fee basis due to their dedication to expanding the rights of those seeking access to medical marijuana. The corporate Trustee has retained outside counsel to defend it in the action. Counsel has indicated that they have been served with voluminous discovery requests. The corporate Trustee is facing the potential of very high attorneys' fees, and therefore would like to pay its attorneys directly from the trust fund. Upon review of the Trust Agreement, however, counsel has determined that the corporate Trustee must await the conclusion of the litigation before it's fees can potentially be paid from the trust fund. The relevant provisions of the Trust Agreement are as follows:

### “Trustee Powers

1. To employ, retain, or consult accountants, investment counsel, brokers, attorneys-at-law, and other professional advisors, and to pay from the income or

principal of the trust any reasonable commissions, fees and expenses in connection therewith.

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Trust Administration Provisions

D. No Trustee shall be required to render annual or other periodic accounts to any court. Each Trustee may take action for the approval of its accounts at such times and before such courts, or without court proceedings, as it determines in its sole discretion. All of the Trustee's fees and expenses (including reasonable attorney's fees) attributable to any accounting and/or approval in lieu of an accounting shall be paid by the trust.

E. The Trustee of each trust hereunder shall be indemnified and held harmless against any threatened, pending or completed action, claim, demand, suit or proceeding, provided that Trustee has not acted with willful misconduct. Such indemnification shall include all expenses incurred by the Trustee in connection with such action. The cost of indemnification shall be apportioned against the various trusts created hereunder as the Trustee determines, it is sole discretion.”

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The problem presented here – lack of a clear provision providing for the advancement of attorneys' fees – could be addressed by having a provision that expressly addresses the issue. A sample provision might provide:

“Trust Administration Provisions

H. Trustee shall be indemnified and held harmless by each trust created hereunder for all costs, expenses and charges, including reasonable attorneys' fees, arising from any action which results from the administration of such trust (unless Trustee has acted with willful misconduct). Such expenses shall be advanced from the trust as such expenses

are incurred by the Trustee and need not await any judicial determination that such Trustee is entitled to indemnification and reimbursement; provided, however, that if a court of competent jurisdiction subsequently determines that the actions of the Trustee constituted willful misconduct, such Trustee shall repay to the trust the amount expended from the trust for such indemnification.”

### Case Study #6 – Segmented Functions

A Delaware corporate Trustee is administering a sizable trust in which the initial holding is an ownership interest in a private company. The intent of the Settlor and the Trustee when the trust was created was that once the interest is sold, the corporate Trustee would manage the proceeds and be responsible for investments. Until then, the corporate Trustee did not want to have responsibility for the private company, and instead preferred to act at the direction of an Investment Direction Adviser with respect to such assets.

The Trust Agreement was originally drafted by an out-of-state attorney, and the process became more cumbersome than perhaps it needed to be. Rather than appointing an Investment Direction Adviser to direct the Trustee as to investments, a multi-step process was put in place. An individual was named as Power Holder. The Power Holder was given the authority to appoint individuals to serve in a number of positions, including Investment Direction Adviser – who can direct the trustee as to investments. In order to implement the sale of the private company interests, several documents were required: (a) the Power Holder appointed himself as Investment Direction Adviser, (b) the Investment Direction Adviser provided a direction letter to the trustee regarding the desired investment, and (c) once the transaction was complete, the Investment Direction Adviser resigned.

The relevant provision of the Trust Agreement are as follows:

“A. The Power Holder may, at any time or from time to time, in the exercise of the Power Holder’s sole discretion and with respect to any of the trusts, appoint one or more persons as “Investment Direction Adviser”.

B. Investment Direction Adviser. Despite the general powers of the Trustees, the following provisions shall apply when an Investment Direction Adviser is serving. If at any time there is no Investment Direction Adviser serving hereunder, then the Trustees shall exercise all rights and powers of the Investment Direction Adviser.

1. The Trustee shall follow the written directions of the Investment Director with respect to the retention, purchase, sale or encumbrance of trust property and the investment and reinvestment of principal and income held hereunder ...”