



The Trust of the Future - Delaware

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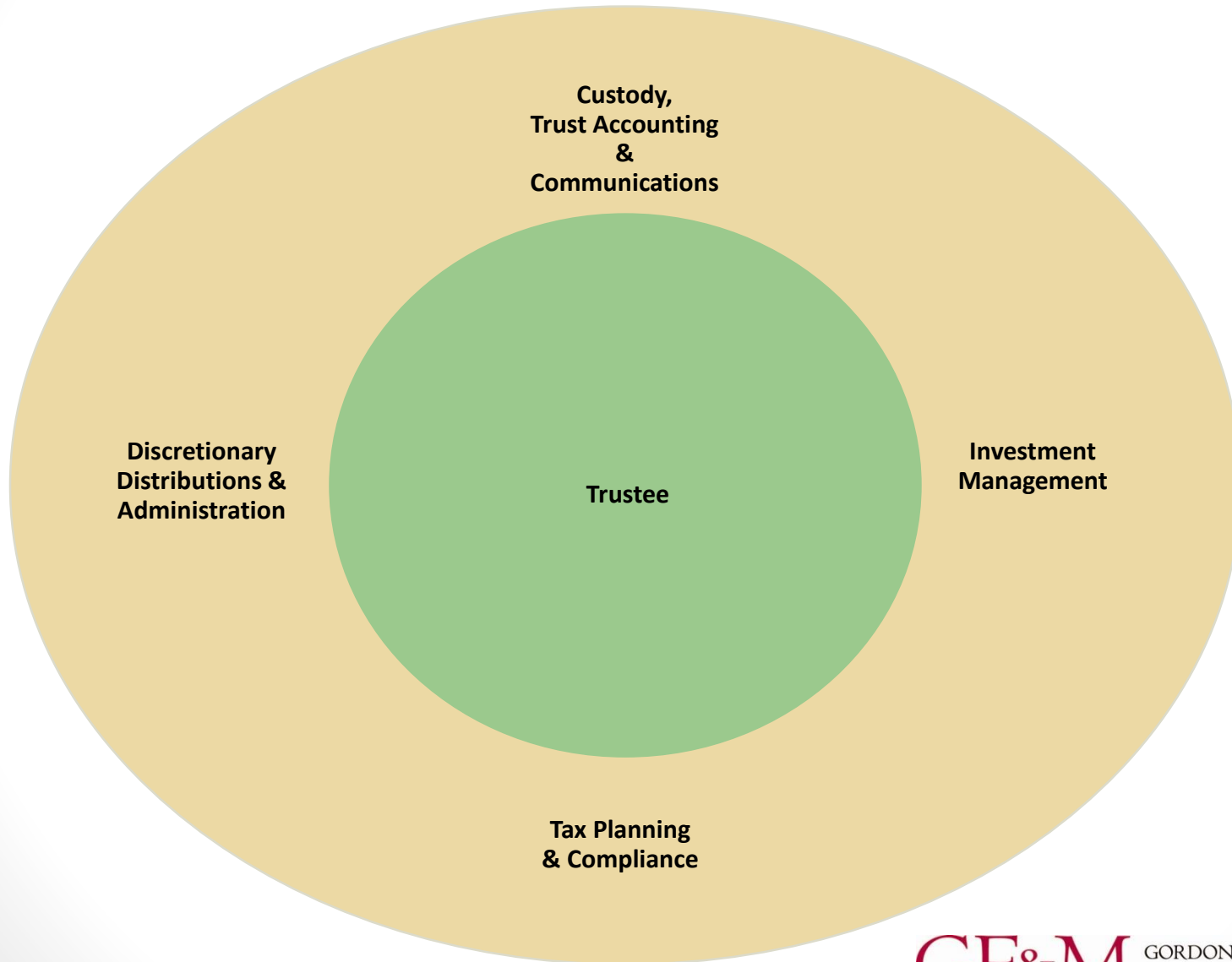
Overview

- Introductions
- Delaware Directed Trust Overview
- Trust Modification in Delaware

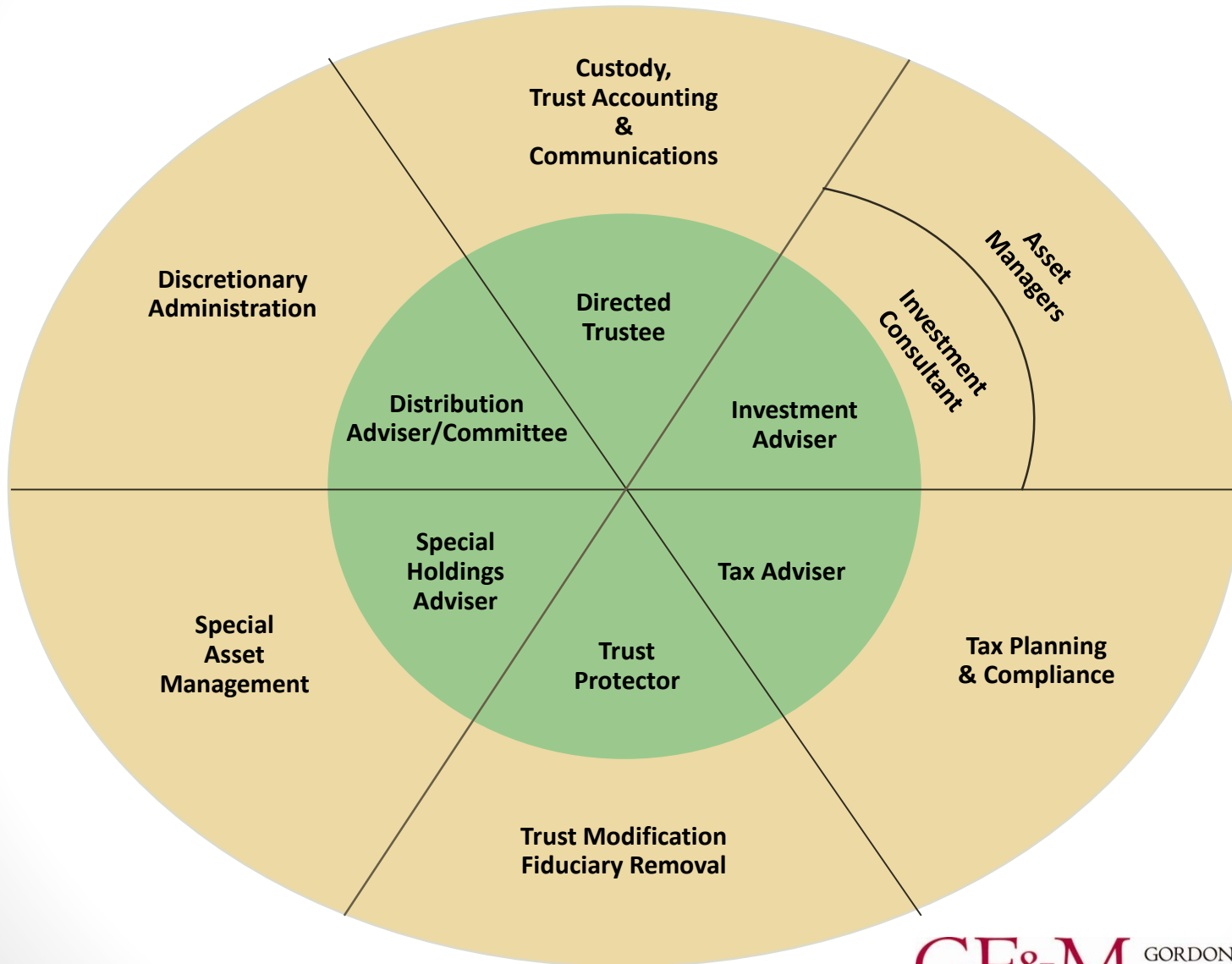
Delaware Directed Trusts - History

- What is a directed trust?
 - A trust that removes one or more powers or discretions traditionally held by the trustee and vests that power or discretion in a person who is either a special trustee or not a trustee at all.
 - Examples of powers or discretions: investment decisions, management decisions, distribution decisions and any other decision affecting the administration of the trust.
- Delaware has a long history of recognizing the concept of directed trusts.
 - In the early 1900s, Delaware began to adopt the practice of allowing directed trusts to accommodate its wealthiest families.
 - Since 1986, Delaware law has expressly allowed trustees to take direction from advisers with limited liability.

Traditional Trust Fiduciary Structure



Directed Trust Fiduciary Structure



Delaware Directed Trusts – Client Suitability

- Investment Advisers
 - Grantors who want to fund a trust with interests in closely-held entities and want to maintain control over the management of such entities.
 - Trusts that contain a concentrated position that has historical value to the family.
- Distribution Advisers
 - May be useful if grantor imposes “productivity”, “lifestyle” standard or other subjective criteria for a beneficiary’s entitlement to distributions.
 - Distribution Advisers can direct the Trustee to decant the assets of the trust into a new trust.
- Trust Protectors
 - To improve the trust’s administration.
 - To modify a power of appointment or to give a beneficiary a power of appointment.
 - To transfer situs and law governing administration.
 - To convert a trust from a grantor trust to a non-grantor trust.
 - To have investment responsibility to certain assets.

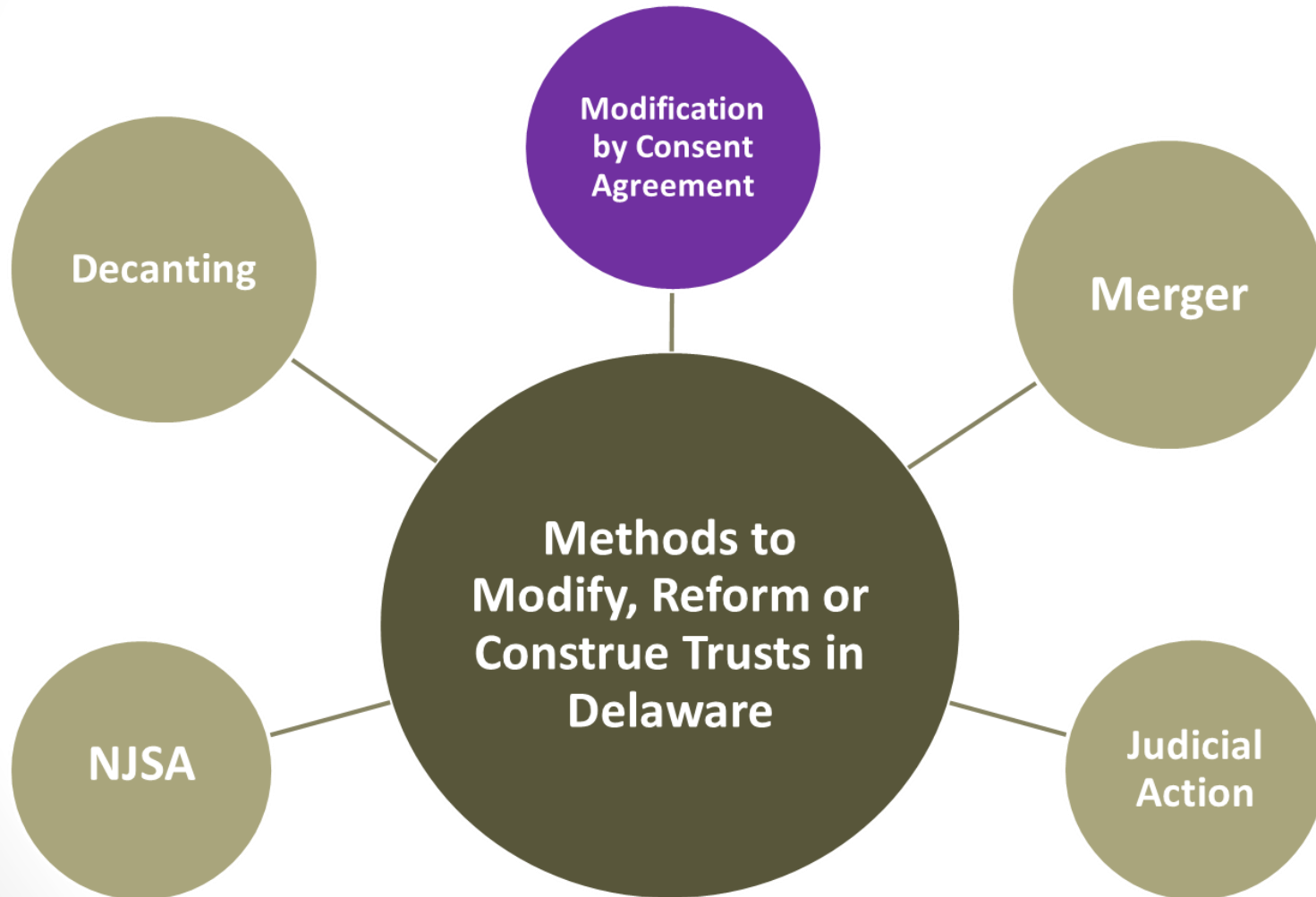
Delaware Directed Trusts – Fiduciary Liability

- Trustee Liability
 - Directed trustees are exonerated except for willful misconduct (12 Del. C. § 3303(a), 3313(b)).
 - The term willful misconduct means *intentional wrongdoing and not mere negligence, gross negligence or recklessness*.
 - The term wrongdoing means *malicious conduct or conduct designed to defraud or seek an unconscionable advantage*.
- Adviser Liability
 - Advisers are fiduciaries by default under Delaware law, unless the governing instrument provides otherwise.
 - The instrument may exonerate and indemnify advisers, except for willful misconduct.

Delaware Directed Trusts – Fee Structure

- Trustee fees for a fully directed trust are significantly less than fees for a discretionary trust.
- In Delaware, administrative trustees fees are typically in the range of \$3,500 to \$10,000 per trust.
- Quote examples from three Delaware trust companies for providing trust services in different capacities for a trust with assets valued at \$13.5 million:
 - Trust Company I (administrative trustee only)
 - Fully directed trust holding an LLC interest only: \$5,000 per year
 - Trust Company II
 - Trustee with discretion for investments only: \$38,250 per year
 - Full discretion: \$58,000 per year
 - Trust Company III
 - Trustee with discretion for investments only: \$37,000 per year
 - Full discretion: \$83,750 per year

Tools Available in Delaware to Modify, Reform or Construe Trusts



Judicial Action in Delaware

- Judicial approval possible, particularly when reforming a trust, but nonjudicial methods preferred
- Procedure is governed by Delaware Court of Chancery Rules 100-104
 - Historically often referred to as “consent petitions”
 - Interested parties, including current and presumptive remainder beneficiaries, must either consent, not object, or take no position with respect to the requested relief

Decanting

- Governed by 12 Del. C. § 3528
- Several states have enacted decanting statutes, and although the requirements in each jurisdiction vary, there are some important conceptual commonalities
 - Principal invasion power: is full discretion required?
 - Consent of, or notice to, beneficiaries
 - Common for trustee to obtain some form of consent, release and indemnification from beneficiaries even if not required under the statute
 - Ability to grant a power of appointment to a beneficiary in the new trust
 - Ability to restrict or eliminate a beneficiary's rights
 - Governing law considerations

Trust Merger

- Governed by 12 Del. C. § 3325(29)
- Trust merger is a process that is mechanically very similar to decanting, and many states have some form of merger statute
 - Delaware's statute provides that a trustee is authorized to:
 - “[d]eclare 1 or more new trusts for the purpose of merging all, or a portion, of an existing trust or trusts with and into the new trust . . . whether or not created by the same trustor and whether or not funded prior to the merger . . . to be held and administered as a single trust if such a merger would not result in a material change in the beneficial interests of the trust beneficiaries, or any of them, in the trust.” 12 Del. C. § 3325(29)

Trust Merger

- Governed by 12 Del. C. § 3325(29)
 - Merger is an exercise of the trustee's discretion, and therefore the same potential liability concerns involved in decanting are present for the trustee
 - May be a good option if trust does not have a principal invasion power and distributions are limited to income
 - In most circumstances, trust merger will not be the best option for adapting the trust if beneficial provisions are being altered, including the creation or alteration of a power of appointment

Nonjudicial Settlement Agreements

- Governed by 12 Del. C. § 3338
- Nonjudicial settlement agreements, or “NJSAs”, are found in some form in the states that have adopted the UTC in whole or in part
 - Interested parties can enter into a binding NJSA with respect to “any matter” involving a trust, but the NJSA is only valid “*to the extent it does not violate a material purpose of the trust* and includes terms and conditions that could be properly approved by the Court of Chancery under this title or other applicable law.” 12 Del. C. § 3338(c) (emphasis added)
 - Statute includes a non-exclusive list of what types of matters can be resolved by NJSA, including the construction or interpretation of a trust, directing a trustee to refrain from a particular act, or granting to the trustee a necessary or desirable power

Nonjudicial Settlement Agreements

- Governed by 12 Del. C. § 3338
 - Important to ensure that all “interested persons” are signing the NJSA or are otherwise bound via virtual representation
 - Close analysis of whether there are any “material conflicts” between adult beneficiaries and any minor, unborn or unascertainable beneficiaries
- Any interested person can bring a court proceeding involving the NJSA

Modification by Consent Agreements

- Governed by 12 Del. C. § 3342
- A potentially very powerful tool available to modify an irrevocable trust is the Trustor is alive
- Signed into law in 2016, and is generally based off of Section 411 of the Uniform Trust Code
- The statute provides:
 - “Notwithstanding any provision of law or a trust’s governing instrument limiting or prohibiting amendment of the trust, an irrevocable trust may be modified to include any provision that could have been included in the governing instrument of a trust created upon the date of the modification by written consent or written non-objection of the trustor, all then serving fiduciaries and all beneficiaries *even if the modification violates a material purpose of the trust.*” 12 Del. C. § 3342(a) (emphasis added).

Modification by Consent Agreements

- Governed by 12 Del. C. § 3342
- Also referred to as “nonjudicial modification agreements” or “modification by consent agreements”
- This allows for extensive modifications not only to administrative provisions of a trust, but of dispositive provisions as well. Awareness of potential tax issues is critical when modifying dispositive provisions
- Any party can seek enforcement of the agreement in Court
- Safe harbor in Treasury Regulations and corresponding PLRs relating to estate tax inclusion risk for the Trustor