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TRUST DECANTING: FLEXIBILITY AND DANGER STRATEGIES

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STRATEGY OVERVIEW

- Evaluate trustee's power to decant
- Evaluate trustee's duties in connection with decanting
- Determining the applicable law
- Address trustee's risk
- Implementation
- Plan ahead

BEFORE DECANTING, THERE ARE TWO TRESHHOLD ISSUES

- First, you must determine whether the trustee has the **power** to decant. In other words, is it possible to decant from the current trust to a new trust with the desired terms under the applicable statute and the trust instrument?
- Second, the decanting must be consistent with the trustee's applicable **fiduciary duties** for making a distribution. In other words, are the changes that the trustee will be making to the governing instrument consistent with the trustee's duties of loyalty, impartiality and care, and consistent with the standards for a distribution of principal?

THE TRUSTEE'S POWER VS. DUTIES

- If the trustee doesn't have the power to decant under the specific circumstances, then decanting is simply not possible.
 - The Trustee must have the power to distribute principal.
 - The differences between the original trust and the new trust must be permitted under the applicable statute.
- However, the issue of whether decanting is consistent with fiduciary duties can often be overcome by releases and/or consents from the beneficiaries.

TRUSTEE'S POWER TO DECANT

- The trustee must have the power to distribute principal.
- Assuming the trustee has the power to distribute all of the principal of the trust, one must then look at the original instrument and the new instrument, identify the differences between them, and assess whether the proposed changes are permissible under the applicable statute.
 - It is generally advisable to get local counsel to make this assessment under applicable law.
- Typically, administrative provisions can be modified in almost any way that is desired.
 - If the only differences between the original instrument and the new instrument are administrative in nature, and the beneficial interests will remain the same, then the analysis is generally quite simple.
- However, if the decanting alters the beneficiaries' interests, then close scrutiny is necessary to ensure that the new instrument does not run afoul of the applicable statute.
 - Generally, you cannot add beneficiaries or change or eliminate the interests of beneficiaries who are currently not proper objects of an exercise of the power to distribute principal.
 - Different statutes may also have other specific limitations (such as the inability to change the income interest under a marital trust or change the vesting of an interest under a 2503(c) trust).

THE TRUSTEE'S FIDUCIARY DUTIES

- When a trustee decants, it is making a distribution of the trust assets pursuant to the terms of the original instrument, and in accordance with the trustee's applicable fiduciary duties.
- In exercising its discretion, the trustee must uphold its duties of impartiality, care and loyalty to all of the trust beneficiaries.
- If there is a standard for making principal distributions in the original instrument, such as an ascertainable standard, then the decanting may still be performed, however, the decanting must comply with the applicable standard.
- Where a trustee has the power to invade the principal of a trust for a beneficiary that is subject to a standard, the trustee owes the other beneficiaries of the trust the duty of care to make some investigation to learn whether the condition precedent to the right to the principal exists and justifies the distribution.
- If the trustee simply abdicates its duties and acts solely upon the request of the beneficiaries, then this potential failure to exercise any discretion concerning the distribution could result in an abuse of discretion.

STANDARD OF REVIEW FOR TRUSTEE'S EXERCISE OF DISCRETION

- If the trustee has discretion to make distributions under the original instrument, then the decision to make the distribution would typically be reviewed by a court under an abuse of discretion standard.
- The trustee should process the decision through its usual procedures for making a discretionary distribution.
 - The trustee should make the decision through its discretionary distribution committee.
 - The trustee should investigate the facts and circumstances.
 - It may be advisable to get advice from legal counsel.
 - The process should be documented.

WHAT LAW APPLIES?

- The decanting is not possible if the laws of a jurisdiction with a common law or statutory power to decant does not apply. You must effectively avail yourself of the enabling law.
- Many statutes provide that the decanting shall be viewed as an exercise of a power of appointment. Under Delaware law, the validity of the exercise of a power of appointment is governed by the laws of the jurisdiction in which the trust is administered. The Delaware decanting statute provides that the statute shall apply to any trust administered in Delaware.
- However, other states may have a different conflicts of laws approach to the applicability of a decanting statute.
- The issues of situs, governing law and place of administration can become complicated, particularly if a trust is being moved to a jurisdiction in order to utilize a decanting statute.
- If these issues are not addressed, there can be risk that the decanting was not proper, or that the trustee cannot effectively obtain releases.
 - It may be necessary to get legal counsel in one or more jurisdictions to address these multi-jurisdictional issues.

TRUSTEE LIABILITY CONCERNS

- A trustee will generally be concerned about the potential liability to beneficiaries for breach of fiduciary duties associated with its exercise of discretion to appoint the trust assets to the new trust, unless the reasons for the decanting are so ministerial and innocuous that it poses little or no risk to the trustee.
- The risk could be limited, or eliminated, if all of the beneficiaries consent to the decanting and release the trustee for all liability in connection with it.
- Of course, it is not always the case that all of the beneficiaries are living adults and there are often contingent remainder beneficiaries who might potentially complain in the future.
- Fortunately, many jurisdictions, like Delaware, have virtual representation statutes that can effectively bind all present and future beneficiaries of the trust if all of the adult beneficiaries release the trustee, and there is no conflict of interest between those beneficiaries and the parties represented (this is more easily accomplished when the changes caused by the decanting are administrative in nature and are not changes to beneficial interests).

TRUSTEE LIABILITY CONCERNS

TWO LINES OF DEFENSE

- A trustee should have two lines of defense in connection with a decanting, if the trustee has the power to make principal distributions in its discretion.
- First, the trustee can get release and indemnification agreements from the beneficiaries with virtual representation binding the minors and unborns.
- Second, even if there is some issue with the release and indemnification, the trustee's actions will be judged under the abuse of discretion standard.
- This provides that the trustee's exercise of discretion will only be overturned if it's actions were arbitrary or capricious, not merely unreasonable.

DECANTING CAN BE VIEWED AS BOTH A TERMINATION OF THE OLD TRUST AND A REMOVAL OF THE TRUSTEE

DECANTING AS A TERMINATION OF THE OLD TRUST

- When a trust is decanted, the assets of the first trust flow over into the second trust, and the first trust is terminated. Not only will the trustee typically seek releases in connection with its exercise of discretion to decant, but it will likely seek releases and an accounting, and any other typical procedure that a trustee in its particular jurisdiction will seek when a trust is terminated and its service as trustee ends.

DECANTING AS A REMOVAL OF THE TRUSTEE

- Since the assets have been transferred to a new trust, which may or may not have the same trustee as the original trust, a decanting can also be viewed from the trustee's perspective as a removal of the trustee of the first trust and an appointment of a successor trustee. consequently, it is advisable to include an indemnification provision in the new, second trust instrument that runs to the trustee of the original trust, even if the individual or corporate identity of the trustee is the same for both trusts (such individual or entity will still be serving in two different capacities).
- Thus, the outgoing trustee knows that if claims, taxes, fees, liabilities, etc. from the original trust arise in the future, which would have been properly payable from the trust, the trustee of the original, now defunct trust can still have some recourse against the new trust to be reimbursed.

IMPLEMENTATION

- Some statutes may permit the trustee to provide notice to beneficiaries or file a notice with the court.
- Generally, a decanting requires a written instrument, signed by the trustee and notarized.
- Depending upon the number of changes, you might simply draft a decanting instrument that provides that the new trust shall be held in accordance with all of the terms and conditions of the original trust subject to some enumerated changes and additions.
- Alternatively, you might draft an entirely new trust agreement and also draft a decanting instrument that memorializes the trustee's exercise of its power to decant the assets of the original trust to the new trust.
 - The new trust could be a declaration of trust, or have the trustee of the original trust as the grantor, or it could have some other person as the grantor.
- Trustee Release, indemnification and approval of account.

PLANNING AHEAD FOR DECANTING

- By far, the biggest hurdle in accomplishing a decanting is the trustee's reluctance to take on the risk associated with the exercise of discretion.
- When drafting new trust agreements, it is advisable to draft enabling provisions in the agreements which limit a trustee's liability and provides indemnification in connection with a decanting.
- This kind of advanced planning might provide the flexibility and protection for a trustee to enable the trustee to perform a decanting in the future, if it is desired by the beneficiaries, without the delay and expense of releases, accountings, indemnifications, etc.