

TRUST ACT 2013 CHANGES TO THE DELAWARE CODE

On August 6, 2013, Delaware Governor Jack Markell signed Trust Act 2013 into law, effective immediately. Trust Act 2013 provides advancements in Delaware trust law that will provide settlors, beneficiaries and fiduciaries of trusts with more tools and greater flexibility to accomplish their various objectives including, most importantly, a statute that permits the use of “nonjudicial settlement agreements” in Delaware.

The Morris Nichols’ Trusts, Estates and Tax Group is pleased to share our annual Delaware legislative update with you. This Alert addresses certain material changes in the law concerning trusts and estates in the State of Delaware and is not intended to be a complete discussion of any of the topics discussed herein. If you would like to discuss any of the issues raised in this Alert in greater detail, please feel free to contact any member of Morris Nichols’ Trusts, Estates and Tax Group. In addition, all of our previous legislative updates, as well as other client updates, are available on our website.

Delaware’s Non-Judicial Settlement Agreement Statute (12 Del. C. § 3338)

The 2013 Trust Act added new Section 3338 to Title 12 of the Delaware Code to permit the use of nonjudicial settlement agreements in Delaware. The new statute is substantially similar to the version in the Uniform Trust Code (the “UTC”) that has been adopted in at least 26 other states and the District of Columbia. The new statute provides settlors, beneficiaries, and fiduciaries an additional option under Delaware law for the resolution of matters arising with respect to the administration of a trust without the time and expense of court involvement.

Subsection (a) – Interested Persons

The new statute requires the consent of all “interested persons” to enter into a nonjudicial settlement agreement. Subsection (a) defines “interested persons” as those persons

whose consent would be necessary to achieve a binding settlement if the settlement were approved by the Court of Chancery.

The Rules of the Court of Chancery (the “Rules” and each a “Rule”) currently permit various matters involving trusts to be addressed through the filing of a consent petition with the Court of Chancery. Subsection (a)(7) of Rule 101 provides that all whose interest in the trust is affected by the relief requested in the petition must consent to the requested relief. Subsection (a)(7) of Rule 101 further provides that such persons include, but are not limited to: (i) trustees and other fiduciaries, (ii) trust beneficiaries with a present interest in the trust or whose interest would vest if the present interests in the trust terminated, (iii) the settlor if living, and (iv) all other persons having an interest in the trust pursuant to the express terms of the trust instrument, such as holders of powers and persons with other rights held in a non-fiduciary capacity.

Accordingly, for purposes of entering into a nonjudicial settlement agreement under the new statute, interested persons include, at minimum, all of those persons identified in Subsection (a)(7) of Rule 101. Delaware’s virtual representation statute, Section 3547, should be available for purposes of binding those interested persons who are minor, unborn, unascertainable or contingent successor remainder beneficiaries.

Subsections (b), (c) and (d) – Matters That May Be Resolved

Subsection (b) of Section 3338 provides that, except as provided in Subsection (c), interested persons may enter into a binding nonjudicial settlement agreement with respect to any matter involving a trust with one exception. The exception relates to charitable trusts and noncharitable purpose trusts described in Section 3541.

Subsection (d) of Section 3338 provides a list of six matters that may be resolved by a nonjudicial settlement agreement: (1) interpreting or construing the terms of a trust; (2) approving the report or accounting of a trustee; (3) directing a trustee to refrain from exercising a power or granting a power to a trustee; (4) resignation,

appointment, or determination of compensation of a trustee; (5) transferring the principal place of administration of a trust; and (6) determining the liability of a trustee for an action relating to the trust.

A comment to the UTC version of subsection (d), which is identical to Delaware's version, provides that this is a "nonexclusive list" of matters that can be resolved by a nonjudicial settlement agreement. Since the terms of Subsection (d) of the new statute track the UTC version and the new statute expressly provides that it may be used to enter into an agreement with respect to "any" matter involving a trust, Subsection (d) plainly provides a nonexclusive list and, as such, Section 3338 is a useful new tool for addressing a wide variety of matters related to the administration of trusts.

Subsection (c) of Section 3338 provides certain limitations for the subject matter of a nonjudicial settlement agreement. Subsection (c) provides that a nonjudicial settlement agreement is valid only to the extent that 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. The term "material purpose" is not defined in new Section 3338 or in the UTC, but is generally understood to require an assessment of the purposes of the trust from the perspective of the intent of the settlor at the time the trust was created.

Subsection (e) – Court Oversight

Finally, Subsection (e) of new Section 3338 provides that any interested person may bring a proceeding in the Court of Chancery to interpret, apply, enforce, or determine the validity of a nonjudicial settlement agreement. Subsection (e) expressly provides that such a proceeding may include seeking a determination that virtual representation under Section 3547 was proper.

Subsection (e) of Section 3338 departs from the UTC version, which simply provides that an interested person may request court approval of a nonjudicial settlement agreement. The broader scope of Subsection (e) of Section 3338 reflects the Court of Chancery's plenary power over matters involving trusts.

Revision of the Definition of Governing Instrument (12 Del. C. § 3301)

Section 3301 of Title 12 defines certain terms that are used throughout Chapter 33 of Title 12 and provides rules for the construction of terms in instruments governing trusts. Subsection (a) of Section 3301 provides that Chapter 33 applies to fiduciaries that act under a "governing instrument".

Section 2 of Trust Act 2013 revises the definition of "governing instrument". The revised definition in Section 3301(e) expressly states that a governing instrument includes any instrument that modifies a governing instrument or alters the duties and powers of a fiduciary or other terms of a governing instrument. The revision makes clear what was already commonly understood – that a document that modifies an existing governing instrument, such as a court order or decanting instrument, will be treated as a governing instrument for purposes of applying the other provisions of Chapter 33.

Clarification Regarding Fiduciaries Who Hold Investments Subject to the Direction of an Adviser (12 Del. C. § 3302(c)(3))

Section 3302 of Title 12 imposes a prudent person standard on a fiduciary in making investment decisions with respect to a trust. Subsection (c) provides that the propriety of an investment decision is to be determined by what the fiduciary knew or should have known at the time of the decision based on three considerations. Before the revisions made by Trust Act 2013, Subsection (c) provided that the fiduciary had no duty to inquire as to the nature and extent of investments and resources available to the beneficiaries outside of the trust.

In a typical Delaware directed trust, the investment duties of a trustee are bifurcated from all other duties such that investment decisions are made by an "adviser" who directs the trustee with respect to investment decisions. In such cases, the trustee generally continues to hold the trust assets but makes investment decisions only upon the direction of the adviser.

Section 2 of Trust Act 2013 revises Subsection (c)(3) of Section 3302 to provide that if a fiduciary holds a trust or trust account, but investment decisions regarding a portion

of the trust account are made only upon the direction of an adviser, the fiduciary has no duty to inquire as to the nature and extent of the assets held in the directed portion of the trust account in order to satisfy the trustee's duty to act prudently when making investment decisions with respect to the non-directed portion of the trust account. This revision clarifies that a fiduciary's duty of inquiry does not turn on whether or not the fiduciary literally holds the trust assets, but instead turns on whether such assets are held upon the direction of an adviser.

Clarification Regarding Effect of Provisions of a Governing Instrument (12 Del. C. § 3303(a))

Delaware law gives maximum effect to the intent of the settlor of a trust as expressed in the terms of a governing instrument. The only statutory limitation imposed by Section 3303(a) on a governing instrument is that it may not exculpate or indemnify a fiduciary for its own wilful misconduct.

Section 2 of the 2013 Trust Act amends Section 3303(a) to provide that the terms of a governing instrument may expand, restrict, eliminate, or otherwise vary any "provisions of general application to trusts and trust administration". The intent of this amendment is to clarify that a governing instrument can vary any rule under Delaware law that would apply to a trust but for a contrary provision in the trust's governing instrument even if the rule is not subsumed within any of the other broad categories of matters listed in Section 3303 that may be controlled by the terms of a governing instrument.

Clarifications Regarding Section Providing Creditor Protection for Tenancy by the Entireties Property Conveyed to a Revocable Trust (12 Del. C. § 3334)

The 2010 Trust Act added Section 3334 to Title 12. The purpose of Section 3334 was to permit married couples to contribute tenancy by the entireties property to a revocable trust without losing whatever creditor protection they enjoyed when holding the property as tenants by the entireties. Section 3334 provides that when a husband and wife contribute property to a revocable trust that, before

contribution, was held by them as tenants by the entireties, the sole remedy available to a creditor of either or both spouses seeking to satisfy the debt out of trust property, is an order directing the trustee to transfer the property to both spouses as tenants by the entireties. Section 3334 was later amended by the 2011 Trust Act to make clear that the two spouses may contribute their respective joint interests in the property to different revocable trusts, a common estate planning technique for married couples, without losing the creditor protection afforded by the statute.

Section 2 of the 2013 Trust Act makes two clarifications that are not intended to result in substantive changes to Section 3334. First, as Delaware legalized same-sex marriage in 2013, the reference to "husband and wife" was deleted in favor of the term "spouses" to clarify that Section 3334 is intended to apply to same-sex couples. Second, certain language was deleted in favor of simplified language which clarifies that Section 3334 is intended only to address remedies available to creditors of either or both spouses in an action concerning whether such creditor can recover the debt from a revocable trust.

Non-Judicial Appointment of Successor Trustee in Certain Circumstances (12 Del. C. § 3336)

Section 2 of the 2013 Trust Act creates a non-judicial mechanism for the appointment of a successor trustee by the beneficiaries of a trust in certain prescribed circumstances.

New Section 3336 is available to beneficiaries if (1) a trust has no trustee serving because the last trustee died, is incapacity, or resigned, (2) the governing instrument of the trust does not provide a mechanism to appoint a successor trustee, and (3) the only remaining dispositive provisions of the trust require immediate distribution of the remaining trust property to one or more beneficiaries either outright or in further trust.

If all three conditions are satisfied, the beneficiaries entitled to take the remaining trust property may, by a unanimous vote, appoint a successor trustee without the approval of the Court of Chancery. The new statute also makes clear that if any remaining trust property is to be distributed to the trustee of another trust, the trustee(s) of the other trust are entitled to vote.

Codification of Existing Law When Claims Against a Decedent's Revocable Trust Are Barred By Reason of a Bar on Claims Against a Decedent's Estate (12 Del. C. § 3337)

Section 2 of the 2013 Trust Act codifies existing Delaware case law regarding claims brought against decedents' revocable trusts. New Section 3337 concerns derivative claims brought against revocable trusts – that is claims that arise against the decedent or his or her estate, but not directly against the revocable trust. In such cases, existing Delaware case law provides that the claims are barred against the revocable trust to the same extent they are time barred against the decedent's estate by any applicable statute of limitations or repose. The new statute codifies this existing Delaware law.

Revisions to the Delaware Decanting Statute (12 Del. C. § 3528)

Section 3 of the 2013 Trust Act revises Section 3528(e) to expressly provide that no trustee or adviser shall have a duty to exercise its statutory power to decant. Section 3528(e) now also provides that a trustee or adviser is not liable for failure to exercise or failure to consider whether to exercise its statutory power to decant absent its own wilful misconduct.

Revisions to the Delaware Virtual Representation Statute (12 Del. C. § 3547)

Delaware's virtual representation statute, Section 3547, allows certain minor, unborn, and unascertainable beneficiaries and contingent successor remainder beneficiaries to be represented in judicial proceedings and nonjudicial matters without the need for a court to appoint a guardian *ad litem*. Whether such a beneficiary may be represented by another beneficiary under the statute turns on whether the representative and represented beneficiary have a "substantially identical interest" with respect to the particular matter and no "material conflict of interest" exists between them with respect to the particular question or dispute.

Section 3 of the 2013 Trust Act adds Subsection (e) to Section 3547 to create three factual scenarios where a material conflict of interest between the purported representative and beneficiary will be presumed. These three scenarios

track language that is part of Court of Chancery Rule 100 regarding consent petitions.

First, a material conflict of interest will be presumed if the purported representative will be appointed to a fiduciary or non-fiduciary role with respect to the trust, unless the representative already serves in such a role and will not receive greater authority, broader discretion, or increased protection as a result of the judicial proceeding or nonjudicial matter.

Second, a material conflict of interest will be presumed if the purported representative currently holds a fiduciary or non-fiduciary office and will receive greater authority, broader discretion, or increased protection by reason of the judicial proceeding or non-judicial matter.

Third, a material conflict of interest will be presumed if the purported representative has any other actual or potential conflict of interest with the represented trust beneficiary with respect to the particular question or dispute to be resolved, such as a conflict resulting from different investment horizons or different interests in present income and capital growth such as the conflict that commonly exists between current income beneficiaries (who prefer income) and remainder beneficiaries (who prefer preservation of principal).

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