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Construction Lenders and Mechanics' Liens

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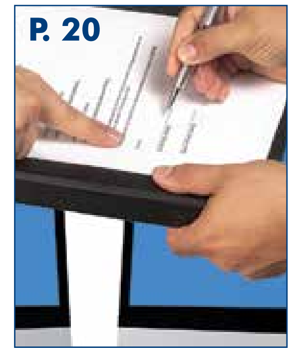

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View from the Chair

by
Elizabeth D. Albano
President & Chief Executive Officer
Artisans' Bank

Chair
Delaware Bankers Association

"One advantage to being knocked down is that it allows you to look up, and get a fresh perspective on circumstances. "

In 1926 Jack Dempsey lost his world heavyweight boxing title to Jean Tunney. When his wife asked him what happened, Dempsey replied: "Honey, I just forgot to duck." Most of the world is now feeling like Jack Dempsey in the aftermath of the devastating COVID-19 pandemic. Like a crushing roundhouse punch, very few of us saw the virus coming, nor did we anticipate the impact it would have on every aspect of normal life from social interactions, to business, to a simple visit to the local grocery store.

One advantage of being knocked down is that it allows you to look up and get a fresh perspective on circumstances. Few people welcome a crisis. Crises are naturally seen as dangerous, expensive, and at the very least, a distraction from our normal lives. But a crisis can also provide great opportunities.

The COVID-19 pandemic has exercised our minds to develop solutions to problems previously unimagined. How do you serve customers with the least amount of physical contact? For many businesses - banks and restaurants most prominently - the drive-up window, previously just a convenience, became the solution to the need for social distancing. How do you hold a meeting with staff and clients from a dozen different kitchens and home offices? Technology platforms that had been occasionally helpful became vital to daily operations. Again, we employed existing tools and repurposed them to meet the need. In the process, we've become more flexible and ready for future challenges.

The current crisis has also given us the opportunity to test new strategies. A friend of mine had an uncle who thought the best way of teaching him to swim was to throw him in the deep end of the pool. While he didn't appreciate the method then, (and still doesn't), he survived. It wasn't graceful. There was a lot of thrashing around and splashing, and some effort that proved counterproductive. But he quickly found out what worked and what didn't to reach his immediate goal of not drowning. There's nothing like being thrown into the deep end of the pool to help you find out what works and what doesn't in the effort to stay afloat.

Just a few months ago, our days were packed with business meetings, dinners with friends and families, vacation plans, and many more diversions. During the quarantine, a stroll to the mailbox became an outing to look forward to. But in this effort to social distance, an unexpected dividend has appeared: time. In our society, idle moments are like a vacuum that demands to be filled. But what do you do once your Netflix streaming has run to a feeble trickle? A tremendous opportunity for self-improvement has been presented. Whether it be in exercising our bodies (to burn off what's been termed the "Quarantine Fifteen"), or flexing our minds and improving our professional skills (with an online course (see debankers.com - shameless plug), now you have time to do those things you always meant to do.

It is important to deal with the immediate needs of a crisis, but it is also necessary to look for opportunities that hadn't existed before. And when the crisis passes, we need to digest the lesson learned so we'll be ready for the next emergency. Remember, crises never last, but whether it's major or minor, there's always another one on the way.

So, until we meet again, face-to-face (minus face masks and sweatsuits), in a land where the sun shines (and paper products are plentiful), let me leave you with this thought: Life is a continuous process of getting used to things we hadn't expected.

All the Best,

Beth

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President's Report

by
Sarah A. Long
President, CEO & Treasurer
Delaware Bankers Association

At no other time in our Nation's history have so many had to think so "imaginatively about their family, work and community lives."

National "Take Our Daughters and Sons to Work Day" is recognized annually on the fourth Thursday in April. Technically, it was called "Take Our Daughters to Work Day," when first celebrated on April 22, 1993. But in 2007, the organization behind the event changed the name to "Take Our Daughters And Sons To Work" to "encourage both girls and boys across the country to dream without gender limitations and to think imaginatively about their family, work and community lives."

According to the national "Take Our Daughters and Sons to Work" Foundation that administers the event, the program "connects what children learn at school with the actual working world. "Take Our Daughters and Sons to Work" helps girls and boys across the nation discover the power and possibilities associated with a balanced work and family life."

I remember how fortunate I was to work for an employer who wholeheartedly supported the program. It was an honor for me first to bring my daughter, and then my son to work with me. Like most children, my children loved playing any game that had anything to do with money. Whether role-playing as a cashier at the local grocery store or playing the role of the Monopoly banker in charge of all the money, property, houses, and hotels still belonging to the bank.

Knowing I was a 'banker' in real life, it was an easy sell to have them accompany me. Not to mention the added benefit they received from having a day off from school! I still vividly recall my daughter sitting in a conference room chair, three times her size, imagining what it would be like to one day take a seat at the table. I still have and cherish the credit card image my son created and produced with the assistance of some very talented in-house advertising associates. It was a true gift to be able to share that experience. Not to mention, they gained a perspective of what Mom did all day!

Fast forward twenty-seven years, and like so many events, "Take Our Daughters and Sons to Work" has been impacted by COVID-19. Participants are urged to choose a date later this year to hold an event. So many people are now working from home, that children have never been more connected to the actual working world than they are now. The surroundings that parents are currently working from - kitchens, living rooms, and dens - are vastly different from the buildings where they usually work. As a result, children are truly learning what a family-friendly work and learning environment is all about.

At no other time in our Nation's history have so many had to think so "imaginatively about their family, work and community lives." During this time of self-isolation and social distancing, girls and boys across the nation are discovering and learning first-hand what it means to try to balance work and family life. During these stressful times, this poem by Diane Loomans reminds me of what really matters in life, so I pass it along to you.

If I had my child to raise over again:
I'd build self-esteem first
    and the house later.
I'd finger paint more
    and point the finger less.
I would do less correcting
    and more connecting.
I'd take my eyes off my watch
    and watch with my eyes.
I would care to know less
    and know to care more.
I'd take more hikes
    and fly more kites.
I'd stop playing serious
    and seriously play.
I would run through more fields
    and gaze at more stars.
I'd do more hugging
    and less tugging.
I'd see the oak tree in the acorn more often.
I would be firm less often
    and affirm much more.
I'd model less about the love of power;
    And more about the power of love.

Stay well!

Sarah

THE POWER OF CHANGE

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What's New at the DBA

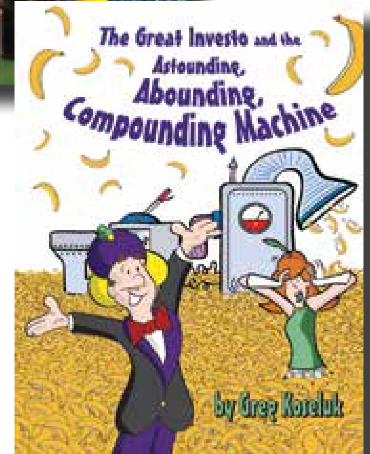
2020 Washington Visit

The Delaware Bankers Association conducted their annual DBA Senior Executive Washington Visit, March 4th through 6th. The 2020 Washington Visit provided attendees the opportunity to meet with key regulators at the FDIC, the OCC, the Federal Reserve and the Treasury. The group also met with Senator Tom Carper, Senator Chris Coons, and Representative Lisa Blunt Rochester. The DBA thanks all their generous sponsors including Platinum Sponsor - The Federal Home Loan Bank of Pittsburgh; Reception Sponsors - Discover Bank; and, Richards Layton & Finger.

Senator Chris Coons and Representative Lisa Blunt Rochester provide an update on congressional matters

Senator Tom Carper addresses the Washington Visit attendees

Teach Children to Save Day



Delaware's 22nd Annual Teach Children to Save Week was celebrated online due to the COVID-19 pandemic. Thousands of students viewed the video on the DBA and DFEA website, as well as on Delaware Banker's YouTube Channel. This year's lesson was on the magic of compound interest, and was taken from the new book on saving: "The Great Investo and the Astounding, Abounding, Compounding Machine." The book was created specifically for the 2020 Teach Children to Save Day event and was made possible with the support of Artisans' Bank, Bank of America, Comenity Bank, Fulton Bank, and WSFS Bank. A free Kindle version of the book was also available all week on Amazon.com.

Elizabeth Albano Succeeds Mark Huntley as President of Artisans' Bank

The Board of Directors of Artisans' Bank elected Elizabeth D. Albano as the Bank's 12th President and Chief Executive Officer and a member of the Board. Beth Albano previously held the position of Executive Vice President and Chief Financial Officer of Artisans' Bank. Beth Albano is currently Chair of the Delaware Bankers Association's Board of Directors. Mark Huntley served as DBA Board Chair 2008-2009.

Mark E. Huntley, Immediate Past President and Chief Executive Officer retired effective April 30, 2020. Mr. Huntley completes almost 42 years of service in both regional and community banking and over 6 years of service with Artisans' Bank. Mark Huntley said, "Beth is a strong leader with a deep understanding of all aspects of community banking. I am confident that she will lead Artisans' Bank and its employees to a bright future."

Beth Albano has been employed by Artisans' Bank for 29 years, serving in a variety of positions with increasing levels of responsibility. Beginning as a Management Trainee within the Audit Department, her career transitioned to the Finance Division where she progressed through various roles including Controller and Chief Financial Officer, making key contributions to the institution in the areas of strategic planning, core data and accounting systems integration, administrative cost control and staff development. In 2017, Beth was promoted to Executive Vice President of the Bank. She has worked closely with Mark Huntley and the Senior Management team to develop policy and ensure effective internal processes. As CFO, she was responsible for the management of the Bank's Finance Division, strategic plan and budget, key regulatory affairs, external financial statement and control audits and tax accounting relationships.

"I am honored to become the 12th President and CEO in Artisans' Bank's 159 year history," said Beth. "I am humbled by the confidence and trust the Board has placed in me and look forward to continuing the critical community bank mission of Artisans' for years to come. I thank Mark for his leadership, mentorship and partnership over the past six years. I am confident as the Bank moves forward that we will continue to serve our customers and communities with excellence thanks to the great team of Artisans' Associates."

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Cover Story

Practical Considerations for Construction Lenders Regarding Mechanics' Liens

by
Sara Toner and Antonios Roustopoulos
Richards, Layton & Finger, P.A.

Until the recent COVID-19 pandemic, development was strong in Delaware. Construction scaffolding, temporary fences, and proud bank signs sharing that construction financing was placed by a certain bank were plentiful. Hopefully, as our state and nation begin to emerge from quarantine lockdowns we will see economic activity resume, led by development. Life will resume and projects will be developed.

Development necessarily involves construction financing secured by the real estate. These loans are risky for many reasons, including the potential for mechanics' liens. Mechanics' liens are harbingers of an array of concerns for a lender, including the overall health of a project. And if a project is in trouble, serious considerations about how a mechanics' lien could affect priority of a lender's mortgage and future construction draws are paramount. Construction lenders expect to be "first in line" when it comes to repayment. If loan funds have been allocated toward a trade or materials and the contractor has not been paid for the work he or she has completed, something has gone wrong. For these reasons, it is almost always an event of default in a construction loan agreement if a mechanics' lien is filed against the property and is not discharged, bonded over, or contested in good faith within a reasonable period of time after filing.

Lenders often focus intensely on when lienable work began and whether, prior to closing a loan, contractors have been paid or will be paid out of loan funds. Delaware's mechanics' lien statute dates the priority of a mechanics' lien as of the date work first began or materials were first furnished to the property, regardless of the actual filing date of the mechanics' lien. Fortunately, Delaware law provides relatively robust protections for construction lenders with respect to mechanics' lien filings. In addition to the law, the practices and customs in which lenders engage in construction financing help to minimize the risk of mechanics' liens taking priority over the lien of a mortgage. This article reviews those practices and customs in relation to the law governing mechanics' liens so lenders can spot the transactional risks associated with construction lending and make informed lending decisions.

A mechanics' lien is a lien on real property—including fixtures—for the benefit of a person who has furnished labor or materials for the erection, alteration, or repair of a structure.[1] The priority of mechanics' liens differ from state to state; in Delaware, the priority dates from the day labor began or the materials were first furnished, meaning that even if a mechanics' lien is not filed until months after the work was completed, its priority will be dated as of the first day the work began.[2] However, a mechanics' lien will not have priority over a first mortgage lien that secures existing indebtedness or future advances, provided that at least 50% of the loan proceeds are used for the payment of labor or materials, or both, for the applicable structure.[3]

The word "structure" is among the broadest words in the English language. The explanation in the foregoing paragraph describes mechanics' liens only with respect to labor performed or materials furnished for the erection, alteration, or repair of a specific structure, which the courts have rigidly interpreted to mean only houses and other buildings permanently situated or erected on the land.[4] Delaware's legislature specifically extended the applicability of mechanics' liens to items that are necessary or component parts of a house or building, such as plumbing, gas fitting, paving, furnishing of machinery in mills and factories, and services rendered and labor performed by architects, among a few others, but that list of items is exclusive. If an item does not appear on the list, it is not, by itself, lienable.[5]

What about contractors who perform work on, or supply materials to, a property that improves only the land and does not relate to the structure itself? Small and large projects alike often budget for at least some combination of site work such as grading, landscaping, construction of private drives, storm water management, and development of common open spaces. These activities are generally not lienable by themselves and require a written contract before a subcontractor can enforce a mechanics' lien. A subcontractor can enforce a mechanics' lien for improvements made to land (and not related to a structure) if and only if (1) there is a signed, written contract with the names of all parties; (2) the contract contains a metes and bounds description of the land; (3) the contract contains a statement of the general character of the work to be done, the total amount to be paid, and the amounts of partial payments; and (4) the contract contains the time when payments are due and payable.[6]

Two recent cases illustrate the dichotomy in Delaware's mechanics' lien statutes. Most recently, one subcontractor that performed landscaping services on the common areas at a residential subdivision filed mechanics' liens on seven of the residential lots, claiming that because the landscaping services were intended to benefit the houses that would be built on the lots in the future, the subcontractor could rightfully file mechanics' liens against the individual lots without evidence of a contract containing the statutorily required information.[7] The court disagreed, concluding that the labor and materials used on the common areas were not necessary or component parts of any structure, and accordingly dismissed the subcontractor's claim. In a similar case involving the same defendant and subdivision, another subcontractor filed mechanics' liens on the same seven residential lots after performing "infrastructure construction services."[8] Although the services performed were more closely related to the houses intended to be built on the lots than landscaping services, the court concluded that the subcontractor's work must be considered an improvement to land because the work was not connected to any ongoing project to construct structures on the lots.[9] Because the lots were vacant, there needed to be a contract between the parties in order for the subcontractor to enforce the mechanics' liens. Although there was a contract between the parties, it did not contain a metes and bounds description of the land. Accordingly, the court dismissed the plaintiff's claims for failure to meet the statutory requirements. As illustrated by these two cases, the statutory requirements that must be met before a contractor can enforce a mechanics' lien are rigid and must be closely followed.

How does a lender protect itself from mechanics' liens being filed against its construction loan collateral? Before funding the loan and recording the mortgage, a lender should pay special attention to whether "vertical" construction of the project has begun. As vertical construction generally refers to the construction of the structure itself, and not site work or other improvements to the land, a contractor or subcontractor, if left unpaid, could enforce a mechanics' lien against the property without needing evidence of a contract between the parties.

If vertical construction has commenced and the loan has yet to close, lenders have two useful and routine tools in their toolbox: the title search (and "bring-down" title search immediately before closing) and lien waiver requirements. A property's title search will tell a lender whether any liens have been filed against the property as of the search date. Because title searches are backward-looking, they should always be "brought down" immediately prior to closing to ensure no intervening liens have been filed between the original search date and the closing date. A lien waiver, as the term suggests, prevents a person from enforcing a mechanics' lien and is typically provided to a construction borrower simultaneously

(continued on p. 12)

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with payment, after payment, or conditionally in expectation of payment by a certain date; lien waivers under any circumstances not involving the payment for labor or materials are void and unenforceable as a matter of public policy.[10] If vertical construction has started, the borrower should either request a conditional lien waiver from the contractor and pay the contractor out of the closing funds, or pay the contractor out of pocket, obtain a lien waiver, and reimburse itself out of the loan funds if desired. As a practical matter, a lender will not close on a construction loan without receiving a policy of lender's title insurance. While the title company may wish to include an exception from coverage for mechanics' liens, lenders will not close with this exception. This tension usually results in the title company being the "police" and verifying that lien waivers have been obtained and that contractors are paid for their work on the closing statement.

Almost every construction lender requires copies of the agreements between the borrower and its contractors and subcontractors as a part of the pre-closing diligence package. Some subcontractors will inevitably perform work solely on the land, such as landscaping, grading, and storm water management, to name a few, and not the structure itself. Given the rigid statutory requirements for contracts concerning improvements made only to land, lenders and their counsel should review these contracts to determine whether the requirements have been met in order for a subcontractor to be eligible to enforce a mechanics' lien against the borrower. However, even if such a subcontractor may be statutorily barred from enforcing a mechanics' lien, nothing prevents a person from exploring all options when seeking compensation for work left unpaid, including initiating litigation for other claims such as unjust enrichment. Litigation takes time and could syphon funds that the borrower would otherwise use to pay debt service. Further, unpaid subcontractors and litigation are major red flags regarding the health of the project—signals that a prudent lender should take seriously. The take-away is clear: prudent lenders should proactively monitor their borrowers' construction activities, paying close attention to the borrower's construction budget and timeline, any completed work, and where each draw ultimately goes in order to ensure no approved work goes unpaid.

Although title searches, lien waivers, contract review, and construction inspections are useful and important tools, lenders have additional protections in Delaware if a lender's mortgage lien is in first position, at least 50% of the loan proceeds are used for labor or materials, and the lender obtains mechanics' lien coverage in its policy of title insurance—by and large the standard in any construction lending transaction. Delaware's statutory "safe harbor" prohibits a mechanics' lien from taking priority over a first lien construction mortgage that secures loan proceeds of which at least 50% is used for labor or materials.[11] Without the safe harbor, a subcontractor that performed work on a structure before the recording of a mortgage, waited until after the mortgage was recorded, and then filed a mechanics lien, if successful, would still have priority over the lien of the mortgage because the priority of a mechanics' lien dates back to the date work was first performed or materials were first furnished. The safe harbor eliminates this risk. Although the foregoing priority issue has never been directly litigated in the 28 years of the safe harbor's existence, the Delaware Supreme Court has generally recognized its effect.[12]

Most recently, the Real and Personal Property Section of the Delaware State Bar Association has proposed an amendment to the statute governing the priority of purchase money mortgages in order to further solidify the priority of first lien mortgages in relation to mechanics' liens. Under the current statute, a "purchase money mortgage" is defined only as a mortgage taken by the seller of a property to secure the payment of the purchase price.[13] The proposed amendment would expand that definition to include any mortgage taken by any lender for the purpose of securing funds advanced to a buyer to pay all or a part of the purchase price—this change extends the definition to institutional lenders. The amendment would also firmly establish the priority of such a lender's lien as superior to other liens, including mechanics' liens, regardless of the date of the other liens if the funds advanced are for the purpose of acquiring a property and the mortgage is recorded within 10 days of the closing. The amendment, if signed into law, would provide additional protections to institutional lenders who provide acquisition financing to developers, further minimizing mechanics' lien risk in the context of construction financing.

Notwithstanding the proposed amendment and the statutory "safe harbor" for construction financing, a lender should nevertheless employ all available tools to minimize the risk of a mechanics' lien taking priority over the lien of the lender's mortgage. These tools include a thorough review of the property's title, the contracts entered into for work at the project, the borrower's construction budget and schedule, and ongoing review of the construction activities performed at the project. Regardless of the stage of a transaction, a team of the lender's own construction consultants and legal counsel can effectively guide lenders through the nuanced issues that may arise during a property's development.

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financial institutions, significant holders of commercial real estate, and institutional clients in all types of commercial real estate transactions. She has particular expertise in closing sophisticated commercial real estate loans, including CMBS financing, portfolio financing, and mezzanine and preferred equity transactions. Sara also regularly advises clients on joint venture formation, equity capitalization, and other real estate matters.

Tony Roustopoulos focuses his practice on matters related to commercial real estate, including the acquisition, sale, lease, finance, and development of commercial real estate properties. He represents developers, lending institutions, and other holders of commercial real estate property in a wide array of real estate matters. Tony attended the Villanova University School of Law, where he served as articles editor for the Villanova Law Review, exchequer for the Phi Delta Phi International Legal Honor Society, and student attorney in the Villanova Law School Federal Tax Clinic. He also served as a judicial intern for the Honorable Kevin J. Carey in the United States Bankruptcy Court for the District of Delaware.

Notes:
1- 25 *Del. C.* § 2702(a).
2- 25 *Del. C.* § 2718(a).
3- *Id.*
4- *See Pioneer Nat. Title Ins. Co. v. Exten Assocs., Inc.,* 403 A.2d 283 (Del. May 18, 1979).
5- 25 *Del. C.* § 2702(b).
6- 25 *Del. C.* § 2703.
7- *See Erosion Control Specials, Inc. v. Hyetts Corner, LLC,* C.A. No. N19L-06-082 MAA (Del. Super. Mar. 6, 2020).
8- *See Pearce & Moretto, Inc. v. Hyetts Corner, LLC*, 2020 WL 532748 (Del. Super. Jan. 31, 2020).
9- The court in this case engaged in a helpful review of prior cases in determining what kind of work is considered actually related to a structure: "paving around a motel" is considered an improvement related to a structure because that work related to the general contractor's construction of the improvements to the motel itself. *See Jones v. Julian*, 195 A.2d 388 (Del. 1963); "the paving of a driveway, not a part of construction of the building erected on the premises" is considered an improvement to land alone. *See Pioneer Nat. Title Ins. Co.,* 403 A.2d 283 (Del. 1979) (citing *Whittington v. Segal,* 193 A.2d 534 (Del. Super. 1963)); paving and curbing of streets within a vacant development is considered an improvement to land only. *See C&J Paving, Inc. v. Hickory Commons, LLC*, 2006 WL 3898268 (Del. Super. Oct. 6, 2006). As demonstrated by the court's review of these cases, the determination of whether work performed is related to a structure is both rigid and nuanced.
10- 25 *Del. C.* § 2706(b).
11- 25 *Del. C.* § 2718(a).
12- *See Builder's Choice Inc. v. Venzon*, 672 A.2d 1, 4 (Del. 1995) ("As a matter of substance, Section 2718(a) gives priority to those first construction mortgages that comport with the statutory definition.").
13- 25 *Del. C.* § 2108.

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Designated Representatives:

Sending Trusted Individuals to the Front Lines

by
J. Zachary Haupt
Morris, Nichols, Arsht & Tunnell LLP

One of the many significant developments in the field of trust law over the past decade has been the increasing popularity of so-called "silent trusts". The term "silent trust" generally describes an arrangement in which a trustee is prohibited under the terms of a governing instrument from providing information to the trust's beneficiaries, or where the trustee is relieved from its common law duty to provide information to beneficiaries, so that information is only shared when it's deemed appropriate.

Although it has been possible to create silent trusts under Delaware law for many years, their popularity has grown following Delaware's enactment of silent trust-related statutes in 2016 and similar legislation enacted in other jurisdictions. As a result of this growth, trustees have increasingly found themselves in predicaments – and subject to increased risk for fiduciary liability – when faced with circumstances where they are unable to obtain releases or to engage in otherwise common transactions because beneficiaries cannot, or should not, be notified of the existence of the trust and other methods of representing such beneficiaries are not available.

Enter the "designated representative," a creation of statute that is designed to address the aforementioned issues by authorizing a person to act on behalf of the beneficiaries whose rights to information regarding a trust are restricted or eliminated. Although designated representatives have proven to be useful in many contexts, they come with their own unique issues and risks that require careful consideration. This article will explore relevant statutory provisions, potential pitfalls and key considerations relating to the role of designated representative.

Statutory Background

In 2016, Delaware added new subsections (c) through (e) to Section 3303 of Title 12 of the Delaware Code and enacted new Section 3339 of Title 12 of the Delaware Code, which, when read together, codify the use of silent trusts and describe the role of designated representative.

Section 3303(d) invokes the designated representative statute, providing: "[d]uring any period of time that a governing instrument restricts or eliminates the right of a beneficiary to be informed of the beneficiary's interest in a trust, unless otherwise provided in the governing instrument, any designated representative (as defined in § 3339 of [Title 12]) then serving shall represent and bind such beneficiary for purposes of any judicial proceeding and for purposes of any nonjudicial matter, and shall have the authority to, and is a proper party to, initiate a proceeding relating to the trust before a court or administrative tribunal on behalf of any such beneficiary." Section 3303(e) defines nonjudicial matters to include, but are not limited to, the grant of consents, releases or ratifications pursuant to Section 3588 of Title 12 and the receipt of a report for purposes of measuring the limitation period described in Section 3585 of Title 12.

Delaware's designated representative statute, Section 3339 of Title 12 of the Delaware Code, provides as follows:

> (a) For purposes of [Title 12], the term "designated representative" means a person who is authorized to act as a designated representative in the manner described in at least 1 of the following paragraphs of this subsection (a) and who delivers to the trustee such person's written acceptance of the office of designated representative. A person who is authorized to act as a designated representative in the manner described in this subsection:
>
> (1) Is expressly appointed under the terms of a governing instrument as a designated representative or by reference to this section;
>
> (2) Is authorized or directed under the terms of a governing instrument to represent or bind 1 or more beneficiaries in connection with a judicial proceeding or nonjudicial matter, as those terms are defined in § 3303(e) of [Title 12];
>
> (3) Is a person appointed by 1 or more persons who are expressly authorized under a governing instrument to appoint a person who is described in paragraph (a)(1) or (2) of this section;
>
> (4) Is a person appointed by a beneficiary to act as a designated representative of such beneficiary; and/or
>
> (5) Is a person appointed by the trustor to act as designated representative for 1 or more beneficiaries.
>
> (b) A designated representative shall be presumed to be a fiduciary.

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In sum, if a beneficiary cannot receive information that would enable such person to adequately represent himself or herself, a designated representative, who is presumed to be a fiduciary, may be appointed to act on the beneficiary's behalf, provided that one or more of the statutorily-prescribed methods of appointment are available. These provisions do not undermine Delaware's already robust virtual representation statute,[1] but rather create an opportunity to appoint someone to represent competent adult beneficiaries or those with material conflicts of interest that could not otherwise be represented under existing statutes. While the designated representative statutes establish a framework to resolve problems that existed prior to their enactment, and can work seamlessly in many instances when supported by well-drafted documents and cooperating parties, pitfalls and potential liability exist for the uninitiated.

Potential Liability for the Designated Representative

A designated representative is presumed to be a fiduciary. Consequently, unless otherwise provided, designated representatives will owe fiduciary duties to the beneficiaries they represent, including duties of care, loyalty, and impartiality. If a trustee or other trust fiduciary commits a breach of trust and the designated representative releases the fiduciary, whether by affirmatively entering into a consent, release or ratification agreement, or by inaction that allows a statute of limitations to expire, the designated representative may become subject to a claim for breach of fiduciary duty when the beneficiaries eventually learn of the harm that has befallen them. Potential for liability may arise every time the designated representative receives an account statement if the statement includes facts that would constitute a breach and the designated representative allows a statute of limitations to expire. These issues can be magnified in the context of consent modifications, decantings, mergers and nonjudicial settlement agreements, which can have profound effects upon beneficial interests and significant tax implications. The risk that is assumed by the designated representative may be far greater than the designated representative anticipated when he or she accepted the appointment.

Who Should Serve as Designated Representative?

Assuming a trustor has determined that a silent trust is the appropriate structure to achieve his or her objectives, the trustor or other person authorized to appoint a designated representative must determine who should be appointed. Trustors frequently desire to appoint a close friend or relative to fill the role of designated representative, and understandably so. This individual is generally someone who the trustor is willing to trust with sensitive information, is familiar with the beneficiaries and will look out for their best interests, and, perhaps most importantly to some trustors, will act in a manner consistent with the trustor's desires. Indeed, sometimes trustors themselves want to serve as designated representative. In making this selection, however, trustors and others authorized to appoint designated representatives tend to value expediency and convenience over competence, and often overlook the potential liability to which the designated representative may be exposed.

First and foremost, the designated representative should be competent to fulfil its fiduciary obligations. Even when a designated representative is "merely" receiving trust accountings until beneficiaries attain a certain age, if the designated representative is not financially savvy, will he or she be qualified to competently review account statements? Moreover, is the designated representative knowledgeable about fiduciary duties and standards of liability so that the designated representative will be capable of monitoring the trust's fiduciaries and holding them to the applicable standards? Finally, in the context of a trust modification or complex transaction, can the designated representative be relied upon to understand the implications of the transaction so that the beneficiaries' interests are adequately represented?

There is no one-size-fits-all approach to identifying an appropriate designated representative, but the appointor and appointee should consider what the role is likely to entail, understand whether the designated representative should possess any specialized knowledge or expertise in order to competently fulfil the role, and understand the scope of potential liability before the appointment is made and accepted.

Compensation and Protection of Designated Representatives?

Because the role of designated representative is often filled by a friend or family member as a favor to the trustor, compensation may not be expected or provided. As described above, however, the action, or inaction, of a designated representative may have the effect of transferring potential liability from the trustee and other fiduciaries to the designated representative. Should the designated representative be compensated for shouldering that risk? Moreover, by receiving trust accountings on behalf of beneficiaries, the trust is spared the expense of judicial accountings. Do those savings justify meaningful compensation to the designated representative?

From a practical standpoint, a professional fiduciary would most assuredly require compensation commensurate with its risk, would acquire fiduciary liability insurance, and would seek advice of counsel prior to participating in any significant transactions that could give rise to potential liability. If the designated representative will not receive compensation or be reimbursed from the trust, the designated representative will either incur substantial personal expense or forego the advice and protection that a professional fiduciary would otherwise require. Even if the designated representative will not receive compensation, provisions that provide for reimbursement for certain expenses or indemnification are worthy of consideration.

Drafting for the Future

Many silent trusts are dynasty trusts that are created to last in perpetuity. Even if the trustor can identify an ideal designated representative to serve in the current situation, circumstances change and the perfect designated representative will not live forever. Consequently, trustors and their counsel should include successor appointment and removal provisions in the governing instrument that will work in perpetuity. These provisions can be complicated by the fact that one or more beneficiaries will not, by definition, be aware of certain facts regarding the

trust, so it can be difficult to identify a prospective designated representative in future generations. These difficulties can be eased by the inclusion of a trust protector or similar role and to either name the trust protector as designated representative or to include the powers to appoint and remove the designated representative among the trust protector's powers.

Scope of Designated Representative Powers

As described above, Section 3303(d) provides inter alia that a designated representative shall represent and bind the represented beneficiaries "for purposes of any judicial proceeding and for purposes of any nonjudicial matter." A plain reading of this language might infer that, unless otherwise limited, a designated representative possesses virtually limitless authority to represent and bind beneficiaries whose rights to information are limited under the terms of a trust instrument. Although a designated representative's authority is undoubtedly broad, there must be some outer limit.

For example, release agreements, which are among the enumerated nonjudicial matters that fall within a designated representative's default authority, often include indemnification provisions whereby a beneficiary agrees to indemnify a trustee or other fiduciary with respect to claims that may arise related to the subject matter of the release. When taken to the extreme, however, it seems highly unlikely that a designated representative could bind a remote contingent beneficiary to indemnification provisions whereby such beneficiary would be obligated to personally indemnify a trustee out of the beneficiary's own assets without regard to whether the beneficiary ever receives a distribution from the trust. What is, or is not, enforceable will depend upon the specific facts of the situation, but it's worth noting that a designated representative may not always have the power to bind beneficiaries to the same extent that beneficiaries can bind themselves with respect to certain transactions.

Nonfiduciary Designated Representatives

Some states aggressively seek to tax income generated by nonresident trusts based upon a single fiduciary residing in their state. Consequently, Section 3339 provides that a designated representative is presumed to be a fiduciary, inferring that the presumption may be overcome by an express statement to the contrary. Indeed, Section 3301(d) of Title 12 expressly contemplates that a designated representative may serve in a nonfiduciary capacity. While a nonfiduciary designated representative may make sense from a tax perspective, it could give rise to unanticipated consequences.

Designated representatives may represent and bind beneficiaries with respect to transactions that can have profound adverse effects upon a beneficiary's interest in a trust. If a designated representative is serving in a nonfiduciary capacity, who exactly has the obligation or incentive to look out for the beneficiary's best interest with respect to such a transaction? Indeed, while Delaware law prohibits a governing instrument from exculpating or indemnifying a fiduciary from liability for willful misconduct, that prohibition does not expressly extend to nonfiduciaries. Consequently, it is possible to construct a fact pattern pursuant

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(continued from p. 17)

to which a beneficiary unknowingly suffers harm, yet all trust fiduciaries are released by a designated representative who is not himself or herself subject to liability and has no personal incentive to prevent the harm. To ensure that beneficiaries' interest are protected, it would be wise to expressly describe a standard of liability applicable to the designated representative in the governing instrument regardless of whether the designated representative serves in a nonfiduciary capacity.

Conclusion

Designated representatives are a welcome and necessary addition to Delaware law. That does not mean, however, that the role comes without risks, that appointments can be made without thoughtful deliberation or that the presence of a designated representative clears the path entirely for trustees relying on them. Rather, interested parties, including those who appoint designated representatives, those who are appointed to serve as a designated representative and those who rely upon the authority of a designated representative, should be conscientious to ensure that the role is fulfilled and administered in an effective manner.

J. Zachary Haupt is an associate at Morris, Nichols, Arsht & Tunnell LLP in Wilmington, Del. Zach's practice focuses on trust law, estate planning and state and federal income taxation. He regularly works with clients to settle new trusts and to modify existing irrevocable trusts through decantings, mergers, consent modifications, non-judicial settlement agreements, administrative amendments, and judicial reformations. Additionally, Zach assists clients with the creation and modification of estate plans and the administration of Delaware estates.

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Notes:
1- 12 Del. C. § 3547

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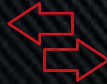
CULTURE & CONNECTION IN REMOTE WORK

SET EXPECTATIONS



Help your team figure out realistic expectations for their work. Clearly communicate tasks, owners, and definitions of success.

RE-DEFINE THE NORMS

Establish the "normal" working hours for the team. How should team members notify each other when they'll be unavailable (e.g. lunch break)? A routine can be beneficial when working remotely for your work / life balance, as well as creating transparency with your team.

COMMUNICATE

Share with your team how best to communicate with you (chat, email, phone, etc). Re-Evaluate the most effective format for each effort. Whenever possible, share your screen or webcam. This "face to face" interaction helps build trust and empathy.

HOLD DAILY CHECK-INS

Ensure you are communicating changing priorities in real time. Start each call with empathy: a "how are you?" can go a long way.

FOCUS ON OUTCOMES, NOT ACTIVITY

Establish and share your definitions of success on any task with your team. Focus on the outcomes and empower your team to work towards shared goals.

MAINTAIN RELATIONSHIPS

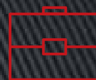
Enable and allow group chats that are non-work-related (virtual water-coolers). Foster interpersonal interactions that amplify team norms and rituals.

DON'T FORGET YOURSELF

Taking care of yourself is just as important as taking care of the team. Don't forget to fit in time for self-care so you can give your team your best!

GET SOME EXERCISE

You may be used to walking as part of your commute, so keep up some physical activity as part of your routine. A group yoga, stretching or meditation session over video could break up the workday and reset minds.



DRESS FOR YOUR DAY

You may not need a suit, but pajamas may not fuel your day.

SET YOURSELF UP

If you're working from a laptop, try adding a mouse, keyboard, or extra monitor to help with posture and alertness.

Remote Online Notarization in Good Times and Bad

by
Brent C. Shaffer
Young Conaway Stargatt & Taylor, LLP

Delaware bankers frequently encounter the need for notary acknowledgments when making mortgage loans, because mortgages must be notarized for recordation in the proper recording offices to establish lien priority. Given the notary's role of guarding against fraud, a Delaware statute provides that a notary may not notarize a document without the person signing the document being personally present. With COVID-19 present, physically appearing before a notary public has become difficult and dangerous. Remote online notarization (the notarization of a remotely-located individual using audio/visual technology) may be a necessary departure from the "in person" requirement.

Remote Online Notarization in Good Times: State Legislation

In 2018, the National Conference of Commissioners on Uniform State Laws, which drafts model acts to encourage state law uniformity, added to the Revised Uniform Law on Notarial Acts (RULONA) a new section 14A that permits remote online notarization. Almost half of the states have passed legislation permitting remote online notarization, most based on RULONA, including Maryland (though its statute does not go into effect until October, 2020). Delaware and Pennsylvania have not. It is expected that a bill to permit remote online notarization will be introduced in Delaware soon, and legislation has already been introduced in the United States Senate to authorize the use of remote online notarization in interstate commerce.

With Section 14A of RULONA, the signor and notary do not need to be in the same room, state or (subject to some additional requirements) country to notarize a mortgage, though the notary must be located in the state where the notary is authorized to act. There are seven requirements:

1. The notary and the signer must be able to communicate with each other simultaneously by both sight and sound.

2. The notary may perform a notarial act for a remotely located individual if the notary knows the individual personally, has evidence of the individual's identity "by oath or affirmation from a credible witness appearing before the notary public," or obtains evidence of the remotely located individual's identity "by using at least two different types of identity proofing."

3. The notary must be able to "reasonably . . . confirm" that the mortgage the notary is being asked to notarize is the same document that the remotely located individual has signed. Section 14A suggests that the signer could e-mail the document to the notary or mail or overnight the "wet ink" original to the notary, who could then hold the document up to the camera or read a portion of the document out loud to the individual to confirm that the record is the same; or the notary public might verify the mortgage by means of a secure electronic signature tied to the mortgage (such as Adobe Sign or DocuSign).

4.The notary must create and retain "an audio-visual recording of the performance of the notarial act."

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5.The notary acknowledgment "must indicate that the notarial act was performed using communication technology."

6.The notary must notify the state's commissioning officer that the notary will be performing remote notarization prior to beginning to do so.

7.Individual state authorities may make rules governing the specifics of the process. Most states require prior to performing remote online notarizations some sort of educational course or testing beyond that required for a traditional notary public commission.

Meeting the second requirement of identity-proofing currently relies on commercial service platforms using a combination of knowledge-based authentication and credential analysis. Prior to establishing an audio-visual connection with a notary, the platform may require the signer to enter some personal information (such as birthdate or driver's license number) and then require the signer to answer a number of questions based on public information (such as "which of the following is a street you have lived on?"). That is followed by the credential analysis of scanning the signer's driver's license, or the notary visually confirming the identification.

Remote Online Notarization in Bad Times: Governors' Orders

In recent weeks, the governors of Delaware, Maryland and Pennsylvania have each issued orders that temporarily permit remote notarization for the duration of the COVID-19 emergencies declared in those states. Because these orders purport to amend the existing in-person requirement of the legislative statutes, there is a question as to their legal effectiveness; nevertheless, it is expected (and stated in the orders) that the recording offices will accept for recording mortgages notarized using the procedures in the orders.

Governor Carney's Eleventh Modification of the Declaration of State of Emergency for the State of Delaware Due to a Public Health Threat, issued April 15, 2020, permits remote notarization utilizing audio-visual technology if the following conditions are met:

1. The notarization is performed by a licensed Delaware attorney.

2. Both the attorney and all persons whose signatures are being notarized are physically located in Delaware (but each may be in different physical locations), and the signers represent this fact during the video conference.

3. For mortgages, the attorney overseeing the transaction shall verify the signer's identity by one of the following: (a) personal knowledge of identity; (b) examining two "Identity Documents" (photo passports, driver's licenses, state-issued identification cards, U.S. military cards, certificates of naturalization, and alien registration cards); or (c) examining one Identity Document and one document postmarked or dated within 60 days from the date of the notarization (i.e. utility bill, cable bill, voter registration card) that includes the signer's name and address as stated on the Identity Document. The verification of identity shall occur during the video conference; not merely by transmitting the identity evidence before or after the video conference.

4. The notarizing attorney must communicate in real-time by video conferencing method where they can see, hear and communicate with the person whose signature is being notarized.

5. The notarized document must state that it was notarized pursuant to the 11th Modification of the Declaration of a State of Emergency, and include the attorney's name and bar/license number.

Each state's order has different requirements (for example, Maryland requires its notaries to notify the Secretary of State in advance that the notary will use remote notarization).

Wait, There's More: Insuring the Mortgage

A loan title insurance policy insuring the lien of the bank's mortgage is always required for both commercial and consumer loans in Delaware. Fearing fraud in mortgage loans closed using Governor Markell's order, title insurance companies are imposing additional requirements beyond those in the order. The requirements vary from company to company. One company allows the order's remote notarization process only to be utilized for residential transactions with a policy amount of $1 million or less (though transactions over $1 million will be considered by the title company on a case-by case-basis). The video conferencing service used must be "secure," and the title company has suggested "best practices" for security, including avoiding free or basic versions of the service, requiring passwords, and using waiting room and meeting lock features and screen sharing encryption and network encryption. Also, the title insurer is requiring one additional method of validating the signer's identity, from

several choices: texting a random number to the signer's phone number confirmed prior to closing; asking a question during the video conference from personal data in the file only the signer would know; or using a third-party identity verification service.

Conclusion

The temporary and truncated remote online notarization procedures quickly put together under the orders serve the critical exigent need of protecting the public during the COVID-19 crisis. As the pandemic recedes better times will come, when RULONA's merits can be more carefully considered by each state's legislature.

Brent C. Shaffer is a partner with Young Conaway Stargatt & Taylor, LLP. As counsel to parties involved in commercial real estate transactions, Brent Shaffer is known for using his experience of over 30 years to focus on the most essential elements and client goals of each transaction, and for his meticulous drafting of documentation to minimize misunderstandings and avoid litigation for each deal as well. . Brent takes a practical approach, based largely on his extensive understanding of the reasoning behind common deal requirements. As commercial real estate transactions grow increasingly complex — with more mixed-use projects, more investors in the debt stack, and more regulation affecting every aspect — Brent's clients rely on him for the advocacy and documentation they need to protect their interests.

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Evaluating Risk in a Health Crisis Event

In evaluating your institution's risk in the case of a pandemic or other health crisis event, it is crucial to conduct a pandemic risk assessment and examine all aspects of the business, from physical locations and personnel functionality to third-party vendor risk and cybersecurity. Identify state and federal legal and regulatory requirements and ensure both that the guidance is incorporated into your pandemic plan and that the institution's Business Continuity Plan (BCP) reflects the latest information from federal and state healthcare officials.

The board of directors should oversee senior management's pandemic response plan development. All areas of the financial institution should be involved in the planning process (e.g., legal, human resources, information technology, business and product areas) and there should be sufficient resources to implement, monitor and test the plan.

Here are some areas many institutions need to consider more thoroughly when performing this risk assessment:

Geographic Risk: Though it may seem like an obvious step, it is important for a firm to understand not only where each of its branches is located, but also track the emerging risk in those areas. This also includes tracking employee travel, both for work and personal reasons. In areas with higher health risks, it is critically important to understand what temporarily shutting down an entire office or branch might look like, or how employees in these areas might be able to work remotely.

Experts believe staffing shortages may be one of the most detrimental aspects of a pandemic event, with outbreaks occurring in waves typically lasting 2 – 3 months at a time and staff being absent during those times. It could be problematic to have all the staff who work on a particular business function be based in the same area, as one of the most realistic concerns isn't just that a large number of employees could contract the disease, but that a large number of employees could be quarantined for coming in contact with the virus or to limit potential exposure. With this in mind, it is also important to plan for how certain foreign, state and local jurisdictions may react to having an outbreak, including potential communication or travel limitations, or even complete travel bans.

Third-party Risk: When working with a third party, especially one that is essential to business-critical functions, such as a data management provider, it is critical to understand their risks in the case of an infectious disease outbreak as well. It may be prudent to examine partners' resiliency programs. If there is indication that systems or processes may not be secure or accessible in the case of staffing issues, your institution may decide to ask the third party to address the issue and provide a written supplemental contingency plan.

Supply Chain Risk: In pandemic planning, it is essential to understand that entire countries or regions might be quarantined. Among other issues, this means disruptions to supply chains. Physical goods from quarantined areas will likely be detained, limited in supply or may not be produced at all. This could prove problematic for business continuity for an institution that relies upon parts or complete systems from suppliers under quarantine. For example, if your institution uses hard tokens for dual-factor authentication and these tokens are manufactured in another part of the world, there could be a delay in or even an impossibility of receiving these parts. Institutions should also identify essential business functions, essential jobs or roles and critical elements within supply chains (e.g., raw materials, suppliers, subcontractor services/products, ATM locations and logistics) required to maintain business operations. Plan for how your business will operate if there is increasing absenteeism or these supply chains are interrupted.

This supply chain risk has already proven problematic with the recent COVID-19 threat as many companies have relied on China for parts manufacturing or personnel support, such as IT professionals, and Chinese companies have struggled to fulfill their contracts amidst catastrophic health concerns.

Data Privacy Risk: Experts agree that the best way to defend against a cyberattack is to think like the hacker. It is not hard to see that the best time to attack someone is when they are already distracted or managing multiple competing resiliency priorities. A pandemic or health crisis event is the prime opportunity for a hacker to infiltrate systems, and it may therefore be prudent for institutions to adjust the tolerance controls on internal and external activity flagging.

One of the most dangerous aspects of this type of attack could be that many hackers in this situation would decide to simply infiltrate and lay low for a period of time. Many institutions will be going

through a number of scenarios, including resetting systems, and may not readily identify anomalous activities. In these cases, it could take months for an institution to notice a breach, as we have seen many times in the past.

It is therefore paramount that during and after an infectious disease outbreak, your institution strengthens controls for its systems and data. It could be beneficial to require another layer of multi-factor authentication during these times, and employees should have a clear understanding of cybersecurity protocols if primary physical locations are inoperable. Additionally, monitoring and surveillance should increase, to help detect any inappropriate access.

A particular area of concern will be phishing and malware attacks, in which bad actors target companies and their employees with virus-related lures to either steal information or launch malicious attacks. The World Health Organization has already published a warning that these attacks have begun, and included several suggestions on how to detect a fraudulent email. It is imperative that all employees understand these risks and the warning signs, along with how to detect and report a scam.

Legal Risk: There are several types of legal risks present in pandemic planning. Among these are the risks associated with a client's inability to access certain products or services, or get the help they may need to access these products or services. If your institution needs to limit face-to-face contact, you must be able to provide services through ATMs and online or telephone banking, considering additional fees that might be waived if a client cannot access the service otherwise, as well potential fair lending and UDAAP considerations. Additionally, employees who become ill and require sick leave or disability pose certain human resources' risks, and it is essential to stay on top of all federal and local labor and employment requirements for disability or reasonable accommodation.

If an employee is confirmed to have COVID-19, employers should inform fellow employees of their possible exposure to COVID-19 in the workplace but maintain confidentiality as required by the Americans with Disabilities Act (ADA). Employees exposed to a co-worker with confirmed COVID-19 should refer to Center for Disease Control (CDC) guidance for how to conduct a risk assessment of their potential exposure.

Institutions should also review their current human resources policies and legal contracts with employees to make sure that policies and practices are consistent with public health recommendations, and existing state and federal workplace laws.

Excerpted from Capco's *Resilience Though Public Health Uncertainty - Managing the COVID-19 Threat*. To read the full report please visit: **www.capco.com/Intelligence/Capco-Intelligence/Resilience-Through-Public-Health-Uncertainty-Managing-The-Covid19-Threat.**

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For Your Benefit

by
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"There is a steady stream of HR Compliance and final rulings forthcoming."

Unpacking the CARES Act

The Coronavirus (COVID-19) pandemic has consumed every aspect of our lives, putting a major strain on daily life in ways we never could have imagined. While this article is probably one of many in this publication and one of thousands in all of the other sources of information flooding your inbox, I thought I'd try to address some of the employee benefit related items that may have been lost in the shadows of the high impact, big news components.

The provision in the $2 trillion plus CARES Act that most of us may be familiar with is the Paycheck Protection Program which provides $349 billion in low interest, partially forgivable, federally-guaranteed loans up to a maximum amount of $10 million to eligible businesses, to encourage retention of employees through the COVID-19 crisis.

The stimulus package also includes a significant expansion of unemployment benefits that will extend unemployment insurance by 13 weeks and include a four-month enhancement of benefits for up to 39 weeks in some states. The enhanced benefits will provide an additional $600 per week on top of what state unemployment programs pay.

The Recovery Rebates are another very widely known provision. They are direct payments to U.S. Resident taxpayers in the amount of $1,200 ($2,400 for couples). Families will receive an additional $500 per child. The payments will start to phase out for individuals with adjusted gross incomes greater than $75,000. Those with incomes higher than $99,000 will not qualify for payments under the stimulus package.

Retirement plan provisions include required minimum distributions (RMDs) from employer-sponsored retirement plans and IRAs will not apply for the 2020 calendar year; this includes any 2019 RMDs that would otherwise have to be taken in 2020. The 10% early-distribution penalty tax that would normally apply to distributions made prior to age 59½ (unless an exception applies) is waived for retirement plan distributions of up to $100,000 relating to the coronavirus; special re-contribution rules and income inclusion rules for tax purposes apply as well. Expanded limits on loans from employer-sponsored retirement plans with repayment delays are also provided.

The Student Loan provisions may be lessor known. They provide a six-month automatic payment suspension for any student loan held by the federal government; this six-month period ends on September 30, 2020. Under already existing rules, up to $5,250 in payments made by an employer under an education assistance program could be excluded from an employee's taxable income; this exclusion is expanded to include eligible student loan repayments an employer makes on an employee's behalf before January 1, 2021.

The Act essentially repeals the Medicine Cabinet Tax provision of the Affordable Care Act (ACA) expanding the list of qualifying medical expense purchases available through your spending accounts to include certain over-the-counter medications and products that may be paid for using HSAs, health reimbursement arrangements (HRAs) and flexible spending accounts (FSAs).

Another lessor know provision is the one allowing telehealth and other remote care services to be covered under a high deductible health plan (HDHP) before the deductible is met, without affecting the HDHP's compatibility with health savings accounts (HSAs). Funding and grants are available for health care providers with connected devices to facilitate telemedicine services, with the goal of freeing up hospital beds and helping rural communities purchase broadband equipment for telemedicine.

Other provisions issued deadline relief to help employee benefit plans, plan

participants and plan service providers impacted by the COVID-19 outbreak. Essentially this relief gives plan participants additional time to comply with certain deadlines affecting COBRA continuation coverage, special enrollment periods, claims for benefits, appeals of denied claims and external review of certain claims. It also gives plan sponsors more time to provide ERISA mandatory notices. Regarding disability, retirement and other plans, the final rule provides additional time for participants and beneficiaries to make claims for benefits and appeal denied claims. Without the extension, individuals might miss key deadlines during the COVID-19 outbreak that could result in the loss or lapse of group health coverage or the denial of a valid claim for benefits.

All the major insurance carriers for medical, dental, life and disability have provided various levels of impactful assistance from expansion of benefits to discounts on monthly bills to extended grace periods.

Lastly, prior legislative relief provisions signed into law roughly two weeks prior to the CARES Act, the Families First Coronavirus Response Act (FFCRA) also include:

- requirements that health plans cover COVID-19 testing at no cost to the patient,

- that employers with fewer than 500 employees generally must provide paid sick leave to employees affected by COVID-19 who meet certain criteria, and paid emergency family and medical leave in other circumstances,

- payroll tax credits allowed for required sick leave as well as family and medical leave paid,

There is a steady stream of HR Compliance and final rulings forthcoming with details relating to many of these provisions.

These updates, along with our previous newsletters and legislative briefs from which this information is attributed, can be obtained by requesting access to our Connect Portal. Please contact The Weiner Benefits GroupTeam for log in credentials or for any additional information. (302) 658-0218.

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Accounting for Success

Revocable Trusts Owning S Corporation Stock

by
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"What happens to a revocable trust when the grantor passes away?"

A revocable trust is an arrangement in which title to property is placed in the name of a trustee with the grantor retaining rights to reclaim the property during their lifetime. A revocable trust may help avoid probate, minimize potential will contest, provide flexibility, and reduce the administrative burden of the estate. Individuals who contribute their S corporation stock to a revocable trust should be very cautious. There are rules which limit the type of shareholder the S corporations can have. If an ineligible shareholder owns S corporation stock, the corporation could lose its "S" status and revert to being treated as a "C" corporation for federal income tax purposes. This could result in additional tax filings, more complicated accounting, and unfavorable tax consequences.

For federal income tax purposes, revocable trusts are treated as being one and the same as the grantor of a trust. A revocable trust's tax information is often reported under the grantor's social security number and therefore is included on the grantor's Form 1040. Since a revocable trust is not treated as separate from the grantor, it is an eligible S corporation shareholder while the grantor is alive.

But what happens to a revocable trust when the grantor passes away? A new separate tax entity would be created on the grantor's date of death and a separate trust tax return would then have to be filed. In general, trusts are not eligible shareholders of S corporations, so the creation of the new separate entity would cause the loss of the "S" status.

Estates are eligible shareholders of S corporations so the easiest way to avoid the loss of the "S" status in this situation would be for the trustee to treat the revocable trust as part of the estate under IRC Sec. 645. The trust (now part of the estate) could be treated as an eligible shareholder of the S corporation for a period of two years after the grantor passes away.

If the trust's ownership in the S corporation continues past the two-year mark, a Qualified Subchapter S Trust (QSST) election must be made for the trust to continue as an eligible shareholder. The election needs to be made within two years, two months, and sixteen days of the death of the grantor. To make the election, the following requirements must be met.

1. The trust can only have one income beneficiary.
2. All income is or is required to be distributed.
3. Any principal distributions must go to the income beneficiary.
4. The income beneficiary's interest must terminate on the earlier of the beneficiary's death or the trust's termination.
5. No distribution by the trust can satisfy the grantor's legal obligation to support the income beneficiary, which would violate items 1 and 3.

Making the QSST election can be easily overlooked so there needs to be proper consideration at the beginning whether stock of an S Corporation even needs to be retitled into a revocable trust. Please note that this article does not cover the Electing Small Business Trust, which may be an option for trusts that do not meet the above criteria.

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Lending Law Update

You'll Need a Corona to Cope With Pandemic-Related Lawsuits

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Delaware employers are still grappling with the many new laws associated with the coronavirus pandemic: new federal laws on COVID-related leave, CDC guidance on proper safety precautions in the workplace, and 13 new executive orders signed by Governor Carney, including the shutdown of all but designated essential businesses. Many have already had to make difficult decisions about their workforce in response to the economic fallout, including layoffs, furloughs, and reductions in employee hours or compensation.

On top of all this, Delaware employers can expect a new wave of litigation to follow these decisions: wrongful termination lawsuits based on age, disability, or whistleblowing, along with health and safety allegations including wrongful death. Below are some of the claims we can anticipate, and key considerations to limit exposure.

Age & Disability Claims

Individuals with certain underlying conditions and those over the age of 60 are especially vulnerable to COVID-19. The EEOC has made clear, however, that an employer's unilateral decision to place an employee on leave, based only on an employee's age or health, is a violation of the Age Discrimination in Employment Act (ADEA) or the Americans with Disabilities Act (ADA)—even when it is done with the employee's best interests in mind. Furthermore, as a result of the pandemic and related screening measures, employers may become aware of employee health issues about which they would not otherwise have known. The employee may later claim that discipline or discharge based on legitimate reasons was instead due to the employee's medical condition, in violation of the ADA.

In addition, if an individual is already out of the workplace on extended leave for COVID-related reasons, he or she might be more likely to land in the first round of layoffs and may claim their termination was due to age or disability. Rehiring after layoffs present more landmines. Some have suggested "restarting" the economy by reinstating younger, low-risk workers before high-risk individuals. If, as an employer, you rehire younger workers while suggesting older workers should stay home, you could run headfirst into an age discrimination claim.

To best defend these types of claims you should make sure that any health information is treated confidentially and communicated only to those with a legitimate need to know, ensure that termination decisions based on performance are well-supported by documentation, and carefully consider the impact of any layoff or rehire decisions on those in a protected class, such as older employees or those with disabilities.

Health & Safety Violations

In addition to discrimination, we are already seeing a host of allegations related to employers' failure to implement adequate health and safety measures for those employees who must be in the workplace. In addressing employee safety, employers should start with the most recent guidance from the CDC, the Delaware Division of Public Health (DHP), and the executive orders issued by Governor Carney. These lay out a series of mandatory steps employers must take, including maximizing remote work opportunities, providing cloth masks to those who cannot work in isolation, and health screenings to ensure that symptomatic employees and members of the public do not enter the workplace. Failure to follow these basic requirements in the present will virtually guarantee claims for work-related injuries ranging from workers' compensation to wrongful death, if the employee suffers the worst outcome.

Employers must also tread very carefully with respect to whistleblower claims. Many employees are coming forward and publicly accusing businesses of failing to provide adequate personal protective equipment, and follow other precautions. Disciplining an employee for such complaints, even when the employer feels the allegations are unfounded, is extremely risky. Employers should understand that an employee's good faith belief that there has been a violation of required health and safety practices is often enough to sustain a whistleblower claim. The employee does not ultimately have to prove he was right to prevail.

Conclusion

As many have noted, we are living through unprecedented times, and the impacts are impossible to predict at this stage. But employers should prepare for the coming wave of litigation, and act deliberately to ensure that they are implementing best practices. Do not let the pervasive sense of panic push your business to rash action. When in doubt, the safest course of action is often a deep breath, and more careful thought about how today's actions will be viewed in twelve months, when we have returned to some sense of normalcy.

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