Directed Trusts & Investments:

Managing Expectations and Ensuring Appropriate Controls and Information Sharing

2016 Delaware Trust Conference

Songs in the Key of Wealth

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I. Setting Expectations

a. Conversations with the relevant parties regarding what an Investment Advisor's responsibilities are generally and specifically as to this trust document

   i. General conversation with the investment adviser to ensure the investment adviser understands his/her role with respect to investments in the trust and what the corresponding role of the trustee is

      1. What is the role of the planning attorney here?

         a. Make sure that the grantor and the investment adviser fully understand the relationship, responsibilities of the various fiduciaries, and limitations on liability of the trustee

      2. Establish/review what "management of the investments of the trust" includes

         a. "investment decision" – definition in 12 Del. C. §3313(d) - the retention, purchase, sale, exchange, tender or other transaction or decision affecting the ownership thereof or rights therein (including the powers to borrow and lend for investment purposes), **all management**, control and voting powers related directly or indirectly to such investments (**including, without limitation, nonpublicly traded investments**), the selection of custodians or subcustodians other than the trustee, the selection and compensation of, and delegation to, investments advisers, managers or other investment providers, and with respect to nonpublicly traded investments, the valuation thereof…

         b. What does "management" mean?

            i. Management of closely held entities

               1. Does this include selection of the manager, exercising voting rights, directing day-to-day operations of a company?

               2. If the trustee is also the manager of the LLC, does the language in 3313(d) permit the investment adviser to direct the manager with respect to investment decisions? Would the trustee still have the protection of the wilful misconduct standard?

            ii. Management of real estate

               1. with respect to real property, does "management" of the real property include obtaining property insurance and/or liability insurance

            iii. "Management" of insurance policies - does management include payment of insurance premiums; ensuring compliance with grace periods; performance reviews?

            iv. Decisions with regard to pursuing legal claims related to investments;

               1. for example: investment adviser directs the trustee to loan money to a company and the company defaults on the loan; the investment adviser wants the trustee to take legal action against the company pursuant to the loan documents

               2. Who makes the decision to exercise the rights in the loan documents? Does investment adviser direct trustee? Does trustee have to make discretionary decision to pursue legal

action? What about the trustee giving a power of attorney to the investment adviser to pursue the claim?

3. 12 Del. C §3325(25) – "Prosecute or defend an action, claim or judicial proceeding in any jurisdiction to protect trust property…"

c. What is "management" relevant to advisory agreements?

i. Can the investment adviser direct the trustee to grant limited trading authority to them? What about directing the trustee to grant a power of attorney to a third party relevant to investments?

ii. What if the trust instrument gives the investment adviser the specific power to hire agents? Does this mean that the investment adviser can hire agents for investment-related activity without involving the trustee?

ii. Establish the method or practice for providing investment instructions to the Trustee

1. Written directions with regard to all investment decisions – trust instrument should provide method for providing directions to trustee. For example, "Any investment direction to the Trustee shall be in writing, delivered by mail, courier, facsimile transmission, electronic mail, or otherwise in such form **as the Trustee may specify from time to time by written notice to the Investment Direction Adviser.**

2. Discuss who will be making the day to day investment decisions and what the best way for both the trustee and the investment adviser will be to communicate the instruments and implement them.

3. Clarify ambiguities from the outset by written agreement between the trustee and the investment adviser

4. What if the investment adviser wants to appoint an agent to deliver instructions to the trustee?

CASE STUDY #1: The trust instrument provides that "any investment direction to the Trustee shall be **in writing**, delivered by mail, courier, facsimile transmission, electronic mail, or otherwise in such form **as the Trustee may specify from time to time by written notice to the Investment Direction Adviser.** The investment adviser entered into an agency agreement appointing her friend as agent and giving the agent the limited authority to "execute, deliver, and receive such documents and instruments on behalf of the investment adviser as she may from time to time direct, either in writing or orally, including without limitation investment directions to the trustees of the trust."

The agent calls the trustee and tells the trustee that on behalf of the investment adviser, she would like the trust to make a commitment to a private equity fund and emails the trust officer the subscription documents. What does the trustee do? What are the concerns the trustee has?

a. Questions for the trustee to consider:

i. Honor the agency agreement and accept the direction? Would at a minimum need to have a copy of the agency agreement and authenticate the investment adviser's signature.

ii. Trust instrument provides that direction must be delivered to trustee in writing; this is an oral direction from the agent. Did the investment advisers put anything in writing and deliver it to the agent? How does the trustee know that the investment adviser wants the trust to make this investment?

iii. What is the scope of the agency agreement? The agreement gives the Agent the authority to "execute [and] deliver…documents…and instructions … on behalf of the investment advisers."

iv. The agent has purportedly been given the authority to deliver instructions to the Trustee, but does the Agent have the authority to make the actual investment decision?

v. What about the trustee's other concerns with regard to the type of investment – would ask the investment advisor to certify the reps and warranties contained in the subscription agreement. Can the agent effectively do this? Even if they can effectively certify the reps and warranties, do they have sufficient knowledge to effectively do so?

vi. What is the goal of the investment advisers? Do they want to delegate the investment decision making to the agent or do they simply not want to be bothered with signing and delivering direction letters?

vii. How can the agent deliver instructions to the trustee orally when the trust instrument provides that direction should be provided in writing?

5. Setting expectations about information sharing between fiduciaries (12 Del. C. §3317)

    a. Valuation of non-publicly held assets on a periodic basis

        i. Sample language - As Investment Advisor for the Trust, and pursuant to 12 Del. C. § 3313(d) and 3317, you have a fiduciary duty, upon request, to keep XXX Trust Company informed about changes in the investments of the trust and other investment decisions, including but not limited to the valuation of nonpublicly traded investments. As such, XXX Trust Company may from time to time reach out to you, as the Investment Adviser for the trust, to confirm activity (or lack of activity) in the trust related to investment decisions you have made and ask for a valuation of nonpublicly traded investments. Such information will enable XXX Trust Company to perform its fiduciary responsibilities related to, for example, accounting to beneficiaries of the Trust and preparing fiduciary income tax returns. By asking for this information from time to time, XXX Trust Company does not intend to monitor you investments decisions or otherwise participate in any investment decisions;

b. The ability to review operating agreement for any entity the investment adviser directs the trustee to create or become a member of for the purpose of becoming comfortable with the rights and responsibilities it is undertaking as the member, manager, partner, officer, director or otherwise

c. Understanding of the benefits of starting the tolling of the statute of limitations for all fiduciaries, Investment Advisors and Trustees alike

b. Initial direction letters – what information should be included? (see sample initial letters of direction)

i. Direct the trustee to hold the investment until further direction by the adviser

ii. Standing letters of direction

1. Example: capital calls – does investment adviser want the trustee to comply with all capital calls as they are received or receive an instruction from the investment adviser each time a capital call is received? If the latter, what about time restraints – what if the direction does not come within the time prescribed by the capital call?

2. Example: every time there is cash in the account, by shares in ABC stock

CASE STUDY #2: The trustee is successor trustee; trust made investments in several private equities before coming on as successor; capital calls and management fees were paid by original trustee and continued to be paid by successor trustee; investment adviser emails trustee and tells the trustee to stop paying management fees and capital calls for one of the private equity investments; what should the trustee do?

a. Obtain letter of direction from the investment adviser directing the trustee to stop paying capital calls and management fees.

b. Have investment adviser acknowledge consequences of not continuing to pay capital calls and management fees; what happens to capital commitments already paid? Are they forfeited?

c. Have the investment adviser instruct how to value the investment going forward.

d. What happens if the fund seeks to enforce the trust's commitment to remaining capital?

iii. Address representations and warranties contained in alternative investment operating documents/subscription agreements – need to ensure that the investment adviser is the one taking responsibility for stating that the representations and warranties in the subscriptions documents are true

iv. Address how cash received into the trust account should be handled, for example, automatic sweep into a money market fund

v. Address market value updates

1. Needs to be clear that the trustee needs to collect market value updates for non-publicly traded investments in order to fulfill its fiduciary obligations to inform beneficiaries about the assets (and value thereof) in the trust, to comply with regulatory requirements and fiduciary duty to report assets under supervision, and to prepare fiduciary tax returns;
2. Report of Condition instructions for DE - **Fiduciary and Related Assets:** Institutions should generally report fiduciary and related assets using their market value as of the report date. While market value quotations are readily available for marketable securities, many financial and physical assets held in fiduciary accounts are not widely traded or easily valued. If the methodology for determining market values is not set or governed by applicable law (including the terms of the prevailing fiduciary agreement), the institution may use any reasonable method to establish values for fiduciary and related assets for purposes of reporting on this schedule. Reasonable methods include appraised values, book values, or reliable estimates. Valuation methods should be consistent from reporting period to reporting period. This "reasonable method" approach to reporting market values applies both to financial assets that are not marketable and to physical assets. Common physical assets held in fiduciary accounts include real estate, equipment, collectibles, and household good
    a. Report of condition does not distinguish between discretionary accounts and directed accounts
    b. For directed accounts, the directed trustee should reach out from time to time to the investment advisers to obtain updated values (based on the investment adviser's methodology, which may differ from investment adviser to investment adviser)

vi. Remind the investment adviser that the trustee will not act unless it is directed by the investment adviser and that it will not monitor the performance of the investments or provide advice about the investments

II. Ensuring Appropriate Controls

a. AML/BSA Concerns and reputational risk concerns with closely held entities and their underlying investments
    i. Assigning risk levels to the underlying trust entities by:
        1. Business type/industry
        2. Location
        3. Complexity of structure
        4. Type of asset (e.g. holding company for investments vs. operating company)
    ii. Reputational Risk – what types of investments would the trust company not be comfortable having a trust invest in (i.e. cannabis business, adult entertainment, etc.) – businesses that may be legal in some states, but, in addition to legal concerns are not deemed by the trust company to be within reputational comfort zone.
    iii. How do trust companies effectively contain these risks?
        1. First and foremost, the trustee can and should perform whatever manner of due diligence (based on business type, location, reputation, etc.) prior to accepting its appointment as trustee

2. Consulting with outside counsel give advice (cannabis example – new PA laws allowing attorneys to give advice where previously forbidden)?
3. Can the risk be removed by convincing the client to make the investment personally rather than through the trust structure?
4. What if the trust company has been given a direction, can it refuse to follow the same based upon reputational concerns? Based on AML/BSA concerns? Can the trustee effectively resign to avoid association with the undesirable investment once given the written direction?
5. What role do Release Agreements play in mitigating risk? How effective are they?
    a. As to beneficiary risk –virtual representation concerns
    b. As to third party risk – IRS and other third parties

b. Are there any true benefits to serving as the manager of a trust owned LLC?
    i. control v. additional liability
    ii. different standards applied to each position (good faith v. willful misconduct) (business judgment rule v. fiduciary duty)
        1. How can a trustee define when their actions are as trustee and when as manager of the entity?
        2. How can the trustee be certain which standard applies when – no clear line

c. What duties exist where there are non-traditional assets (such as art, real property, or insurance) held (i) outright by the trust or (2) within an entity?
    i. Insurance on real property – should the trustee make sure that there is liability insurance and that it is named as an additional insured on the policy?
        1. When held directly in trust, the question becomes whether or not the trustee should secure liability insurance to protect the trusts' assets from claims for liability associated with injuries on the property and/or property insurance to protect the property from loss in value/destruction
            a. Unless the trust instrument provides otherwise, the trustee has the specific power under 12 Del. C. §3325(12) to "insure the property of the trust against damage or loss and insure the trustee, the trustee's agents and beneficiaries against liability arising from the administration of the trust"
            b. When it is a directed trust, who has the power to insure the property and/or insure the trustee?
                i. You need to read the trust instrument and see whether the investment adviser provisions cross-reference this specific trust power, thus giving the power to the investment adviser.
                ii. Also consider the scope of the definition of "investments" or "investment decisions" in the trust instrument and in 3313(d) - "investment decision" includes "management…related directly or indirectly to …nonpublicly traded investments." Does management include insurance-related items?
        2. How does the answer change where there is an entity in between with a manager who is charged with securing the LLC assets? Does the responsibility for the underlying asset effectively transfer to the manager?

ii. tax payments – ensuring the entity and/or the real estate bills are paid

iii. safe-keeping of assets – with art and tangibles

iv. notes receivable – who decides what should be done if the payment is delinquent?

d. What risks exist with hedge funds/private equities?

i. Should the trustee be making the representations and warranties? [consider including a sample letter for hedge funds/private equities and remove the sample language from the outline]

1. Sample direction letter for investment in private equity that addresses representations and warranties:

In my capacity as Investment Direction Adviser pursuant to Article XXX of the above mentioned Trust, I hereby direct XXX as Trustee to effectuate the following transactions:

- Redeem $20,000,000.00 from the XXX Prime Money Market Fund
- Subscribe for a $20,000,000.00 interest in the XXX Fund LLC, and pay all capital calls pursuant to the terms of the investment.

Furthermore, this direction includes, but is not limited to the direction to complete all documents necessary to effectuate this investment, including but not necessarily limited to the subscription documents attached hereto and incorporated by reference (Hereinafter, the "Investments Documents"). In connection with this direction, I further direct and/or advise you of the following:

- I am personally an Accredited Investor and Qualified Purchaser; and
- Opt In for new issues to the extent that they may pertain to this offering

I hereby confirm that I have reviewed the Investment Documents independently and I have not requested (nor have you offered) the advice of XXX Trust Company in regard to the same. I further acknowledge that the Investment Documents include certain representations, warrantees and covenants made by the Trusts, and I agree (a) that this direction includes my representation that the same are true and correct, and (b) that my responsibility as Investment Advisor to the Trusts includes the responsibility to monitor the investments and the actions of the Trusts, and to direct and instruct the Trustees of the Trusts on the future actions, if any, to be taken with respect to such representations, warrantees and covenants, including, without limitation, meeting any obligations under the covenants contained in the same. No Trustee of the Trusts shall be obligated to monitor this investment and/or the actions of the Trusts with respect to any such representations, warrantees and covenants. I acknowledge that any and all review of the investment by the Trustee is solely for statement and/or tax reporting purposes.

ii. How does this change where the fund is held in an entity?

III. Other Means of Protection

a. Release agreements

i. Beneficiary may release fiduciary for possible cause of action

1. When a beneficiary has a possible cause of action and no court has considered the matter, the beneficiary may release the trustee or third party from liability and extinguish any such cause of action.[1]

ii. Requirements of Enforceability of Release

1. A beneficiary may discharge the trustee's liability for a breach of trust unless the beneficiary is incapacitated, the beneficiary does not know his rights or all of the relevant, material facts, the release was induced by improper conduct of the trustee, or the transaction with the trustee was not fair or reasonable.[2]

iii. Fiduciary bears burden of proving the fairness.[3]

1. New York. Petitioner filed action against trustee to revoke letters of administration and to seek an accounting. The trustee's defense was two release agreements executed by the petitioner.[4] The court held that the respondent met the burden of proof of fairness by demonstrating that the petitioner was represented by counsel, apprised of all pertinent facts surrounding the estate, and did not misrepresent any facts.[5]

iv. Fiduciary must fully disclose facts and legal rights of the beneficiary.[6]

1. New York. Remainderman received trust property under a trust, received a statement of the trust administration from the trustee, and subsequently signed a release.[7] The remainderman later claimed that the trustee had mishandled the trust.[8] The court held that the petitioner was a competent adult who executed the release (without fraud or misrepresentation on the part of the trustee) for the accounting that contained a schedule showing the investment in question, and therefore, the release was valid.[9]

2. New York. Upon beneficiary's request, the court withdrew her release, holding that it was invalid because the beneficiary "failed to fulfill [the] duty of disclosure to respondent."[10] The court found that the beneficiary "was not given an opportunity to review the account, either with or without counsel, prior to her execution of the [release]".[11] Further, there was no evidence that the beneficiary was adequately informed of the effect of executing the release agreement.[12]

3. Fourth Circuit. A beneficiary sought to invalidate a release because she thought the document was a "covenant not to sue the life beneficiaries; [and claimed] that she did

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[1] George Gleason Bogert, The Law of Trusts and Trustees § 943 (Sept. 2015). *See also* Austin Wakeman Scott, *Scott on Trusts* § 24.22 (5th Ed. 2007) ("A trustee who commits a breach of trust without the beneficiaries' prior consent may nevertheless avoid liability if the beneficiaries subsequently discharge the trustee by contract, accord and satisfaction, or release").
[2] RESTATEMENT (SECOND) OF TRUSTS § 217 (2016). *See also Scott on Trusts* § 24.22 (5th Ed. 2007) ("A discharge is effective only if the beneficiary had knowledge of all of the material facts that the trustee knew or should have known and of the beneficiary's legal rights, and if the trustee did not improperly induce the discharge.")
[3] Bogert, supra, at § 943.
[4] In re Amuso's Estate, 87 N.Y.S.2d 519, 520 (Sur Ct, Nassau County 1959).
[5] Id.
[6] Bogert, supra, at § 943.
[7] In re Schoenewerg's Estate, 277 N.Y. 424 428 (N.Y. Apr. 1938).
[8] Id.
[9] Id.
[10] In re Estate of Hunter, 190 Misc.2d 593, 594 (Sur Ct, Westchester County 2002).
[11] Id. at *599-600. *See also* Pa. Co. v. Wilmington Trust Co., 186 A.2d 751, 780 (Del. Ch. Dec. 12 1962) (holding that trust beneficiaries were not estopped from arguing that corporate trustee entered into agreement for sale of stock in the trust for less than maximum price available, where corporate trustee disclosed no information of the transaction to the beneficiaries until after corporate trustee entered into agreement).
[12] Id.

not authorize her attorneys to release the remaindermen." [13] The court held that the release was valid because the widow's attorneys negotiated a settlement with her claim against the trust, her attorneys read the release to her, and the beneficiary knowingly executed it.[14]

4. Delaware. An individual trustee's investments declined by nearly three quarters of their value and the beneficiaries filed an action against the trustee for breach of fiduciary duties.[15] The individual trustee claimed that the beneficiary "acquiesced" to several of those investments.[16] The court held that the elements of acquiescence were not satisfied as the beneficiary did not have "full knowledge of all material facts."[17]

v. No Wilful Misconduct

1. Georgia. Trust beneficiaries brought an action against a former trustee and the trustee filed a counterclaim alleging the beneficiaries breached the release.[18] The court held that it is valid under Georgia state law for a business to "relieve itself from its own negligence" so long as it is not for "acts of gross negligence or wilful or wanton conduct," and therefore, the court dismissed the plaintiff's claim finding the release valid.[19]

2. Delaware. 12 *Del. C.* § 3303 states that "a governing instrument may expand, restrict, eliminate, or otherwise vary any laws of general applications to fiduciaries, trusts and trust administration, including, but not limited to, any such laws pertaining to . . . (4) a fiduciary's powers, duties, standard of care, rights of indemnification and liability to persons whose interests arise from that instrument provided, however, that nothing contained in this section shall be construed to permit the exculpation or indemnification of a fiduciary for the fiduciary's own *wilful misconduct* . . ." (emphasis added).

vi. Adequate consideration.[20]

1. Texas. Appellant argued that a release of a trustee was invalid because there was no consideration.[21] The court held that because the release stated that the bank paid the appellant a bonus in exchange for the appellant relinquishing his interest in two properties, the release contained sufficient consideration, and therefore, was valid.[22]

2. U.S. Supreme Court. Feeling pressured by the administrator of his father's estate, a beneficiary executed an agreement transferring all of his interest in his father's estate to his wife and children in exchange for "their maintenance and support."[23] The Court held that the release was invalid since there was no consideration and the assets of the estate were instead "surrendered."[24]

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[13] Nalle v. First National Bank of Baltimore, 412 F.2d 881, 883 (4th Cir. July 10, 1969).
[14] Id.
[15] Mennen v. Wilmington Trust Co., 2015 WL 1914599 at *1 (Del. Ch. Apr. 24, 2015).
[16] Id. at *35.
[17] Id.
[18] Heiman v. Mayfield, 300 Ga.App. 879, 879 (Ga. Ct. App. Oct. 20, 2009).
[19] Id. at 883.
[20] Bogert, supra, at § 943. *See also* Bogert, supra, at § 941 ("If a beneficiary of full age and sound mind, acting with full knowledge of the facts of the case and of his rights, and not under the influence of misrepresentation, concealment, or other wrongful conduct on the part of the trustee or another, consents that the trustee or a third person perform an act or refrain from performing an act, equity will not permit the beneficiary to allege thereafter that the conduct of the trustee or third person to which consent was given was a breach of trust, or amounted to participation in a breach").
[21] Nettles v. First Nat. Bank of Temple, 168 S.W.2d 920, 926 (Tex. App. Feb. 10, 1943).
[22] Id.
[23] Adams v. Cowen, 177 U.S. 471, 483 (U.S. April 16, 1900).
[24] Id.

3. Kentucky. The plaintiff placed bonds in a safety deposit box in the name of the defendant as trustee.[25] The defendant was to pay the plaintiff interest for a period of time and then return the bonds.[26] The defendant refused to return all of the bonds and demanded that the plaintiff sign a release in return for two-fifths of the bonds.[27] The court held that the release was invalid because it lacked consideration.[28]

4. Pennsylvania. A beneficiary released a trustee to terminate a trust in exchange for an annuity.[29] The beneficiary never received the annuity and the trust was not terminated.[30] The court held that the trust could not be terminated without violating the testator's intent.[31] Because the trust could not be terminated, there was no "legal, valuable and adequate consideration for the release."[32]

5. Alabama. Wife sued for divorce after obtaining a release from husband regarding his interest as beneficiary of a trust containing marital property.[33] The Supreme Court of Alabama held the release was valid, even though the release was supported by only $10 of consideration.[34]

vii. Waiver of Accounting as consideration

1. A beneficiary may waive an accounting.[35]

2. Under the Uniform Trust Code, "[a] beneficiary may waive the right to a trustee's report or other information . . . [and a] beneficiary, with respect to future reports and other information, may withdraw a waiver previously given."[36]

3. Delaware. 12 *Del. C.* § 3326 states that a beneficiary may waive a judicial accounting of a testamentary trust.[37]

4. Maryland. Trust beneficiaries brought an action against the trustee alleging that they were improperly required to execute a broad release.[38] The court held that the terms of the release were "not so broad and one-sided as to place impermissibly the trustee's interests before those of [the trust beneficiaries]."[39] The court further found that the terms of the release "track closely, although not perfectly, to the terms the trustee

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[25] Puff v. Puff, 104 S.W. 332, 333 (Ky. Ct. App. Oct. 2, 1907).
[26] Id.
[27] Id.
[28] Id.
[29] First Nat. Bank of Princeton v. Northrup, 21 N.J. Super 71, 78 (N.J. Super. Ct. July 23, 1952).
[30] Id.
[31] Id.
[32] Id.
[33] Ex Parte Miller, 861 So.2d 392, 393 (Ala. Jan. 24, 2003).
[34] Id. at *394.
[35] Bogert, supra, at § 969.
[36] Unif. Trust Code § 813(d).
[37] DEL. CODE ANN. tit. 12 § 3526 (West 2015) ("a trustee or trustees . . . may be released from [a judicial accounting] by the interested parties of the trust if the trustee sends a written notice and request for waiver and consent or nonobjection to the interested parties, which notice shall: (1) Describe the obligation of the trustee under §§ 3521-3524 of this title and identify the alternative means by which the trustee will provide the beneficiaries with the information formerly set in the account; (2) Request the interested person waive the obligations under §§ 3521-3524 of this title with respect to the trust and consent, or signify such person's nonobjection, to the alternative means described in the notice for the dissemination of trust information; and (3) Request that a waiver and consent or nonobjection be executed by: (a) The interested party personally; (b) The interested party's attorney ad litem; (c) A person authorized to represent the interested party under § 3547 of this title or any successor statute; or (d) A person authorized by applicable law to represent the interested party in transaction involving the trust (such as, but not limited to, the interested party's attorney-in-fact or the Attorney General in the case of certain charitable beneficiaries).
[38] Hastings v. PNC Bank, NA, 54 A.3d 714, 718 (Md. Sept. 27, 2012).
[39] Id. at 726.

would have received had it petitioned for (and received) a court order formally approving the accounting and termination of the Trust."[40] Similarly, the court held that the terms of the trustee's release were "not a radical departure from the common law protection and statutory right to which the trustee was already entitled."[41] The court did note that the release would not have protected the trustee from liability arising from "fraud, material mistake or irregularity" on the part of the trustee.[42]

5. Pennsylvania. Beneficiaries executed a release in which they acknowledged a complete accounting by the trustee.[43] In response to a subsequent challenge, the court held that the beneficiaries were barred from all claims in connection with seeking a judicial accounting due to their execution of the release.[44]

6. New York. An income beneficiary executed a release acknowledging the accuracy of the account submitted by the trustees.[45] The beneficiary contended that the release was not binding because it was executed by mistake.[46] The court held that the release was valid and barred the beneficiary from her improper accounting claim.[47]

7. New York. Petitioner waived her right to an accounting in a settlement agreement.[48] Pursuant to the settlement agreement, the trust agreement was modified to make the petitioner a trustee of the trust, the petitioner received "substantial sums of money", and the petitioner's mother agreed to keep in force a will that gave the petitioner one-half of the residue of an estate.[49] The petitioner instituted an action seeking an accounting by the trustees.[50] The court held that the petitioner had "expressly, for a substantial consideration, waived her right to an accounting in the 1978 settlement agreement."[51]

8. New York. A beneficiary executed a consent to modify a trust which caused the beneficiary to lose all interest in the trust and in return received payment that constituted 7/9 of his previous benefit.[52] The court held that the beneficiary had received consideration for his execution of the consent to the modification relinquishing his interest in the trusts, and therefore, barred his right to an accounting.[53]

9. New York. A trustee provided the beneficiaries with a formal accounting revealing significant declines in an investment that made up more than eighty percent of the trust corpus and requested a release prior to distribution.[54] The beneficiaries executed the releases, which provided that the trustee was forever absolved of its liability for its

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[40] Id. at 727.
[41] Id. at 728.
[42] Id. *See also* Scott, supra, at § 23.1 ("Increasingly, there is a statutory authority for the proposition that a trustee's account eventually bars all claims by any beneficiary to whom it has been submitted as to any matter properly disclosed, even without court approval . . . The Uniform Trust Code allows the beneficiaries one year in which to contest any "report that adequately disclose[s] the existence of a potential claim for breach of trust and inform[s] the beneficiary of the time allowed for commencing a proceeding.") *citing* Unif. Trust Code § 1005(a).
[43] In re Grote's Estate, 390 Pa. 261, 269 (Pa. Sept. 30, 1957).
[44] Id.
[45] In re Ohrbach's Trust, 4 Misc.2d 964, 968 (Sup Ct, NY County 1955).
[46] Id.
[47] Id. at 969.
[48] Rosner v. Caplow, 105 Misc.2d 592, 595 (N.Y. Sup. Ct., New York County, Sept. 15, 1980).
[49] Id. at 596.
[50] Id.
[51] Id. at 601.
[52] O'Hagen v. Kracke, 165 Misc. 4 (N.Y. Sup. Ct., Westchester County, Aug. 4, 1937) aff'd 253 A.D. 632, 634 (N.Y. App. Div. Apr. 8, 1938).
[53] Id.
[54] In re HSBC Bank U.S.A., 70 A.D.3d 1324, 1325 (N.Y. App. Div. Feb 11, 2010, *appeal denied*, 14 N.Y.3d (N.Y. 2010).

administration of the trust assets.[55] The court held that the trustee "fulfilled its fiduciary duty by providing [the beneficiaries] with a full accounting of the trust, and [the beneficiaries] failed to object to the accounting and executed releases waiving their rights against the trustee."[56]

10. Delaware. In a case with questionable precedential value, the Delaware Supreme Court held that under Delaware law only two situations provide for fee reimbursement to trustees: (1) "when attorneys' services were necessary for the proper administration of the trust"[57] and (2) "where the services otherwise resulted in a benefit to the trust."[58] The Delaware Supreme Court affirmed the Delaware Court of Chancery order holding that although trustees have a right to an accounting, the right "does not extent [sic] to a judicial accounting nor is its purpose the absolution of the trustee."[59] The court also found that there was no legal duty to account in the State of Delaware and that the trust agreement did not require the accounting.[60] The court found that the purpose of the accounting was solely to "absolve the trustees of liability" and did not benefit the trust, and therefore, the trustee was not entitled to reimbursement.[61]

viii. No Improper Inducement.

1. Florida. A trust beneficiary brought action against trustee for breach of fiduciary duty.[62] The beneficiary claimed that the trustee had a conflict of interest during the administration of the trust and the beneficiary was never notified of this conflict.[63] Evidence was admitted demonstrating that the trustee was working with its attorney to conceal this conflict while seeking a release from the beneficiary.[64] The court found the

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[55] Id.
[56] Id. at 1326. *See also* In re Hunter, 4 N.Y.3d 260 (N.Y. 2005) (holding that an accounting release is "conclusive as to issues that were decided as well as those that could have been raised in the accounting").
[57] Bankers Trust Co. v. Duffy, 295 A.2d 725, 726 (Del. Ch. July 26, 1972) (*citing* William F. Fratcher, *Scott on Trusts*, § 244 (2nd Ed. 1956) and RESTATEMENT (SECOND) OF TRUSTS § 188 (1959)). The applicability of Bankers Trust is questionable and the precedential effect of Bankers Trust is "unclear." *See* Bogert, supra, § 967, fn. 47 (2015). *See also* In re Trust u/a McKinley, 2002 WL 31934411, at *4-5 (Del. Ch. Dec. 31, 2002) (holding that pursuant to the trust agreement, a trustee was entitled to fees when seeking judicial instructions on issues concerning administration of the trust, when a trustee is defending a trust expense, when a trustee initiates a proceeding to determine proper allocations of expenses and when litigation occurs surrounding the trustee's removal); *See also* Merrill Lynch Trust Co., FSB v. Campbell, 2009 WL 2913893, at *13 (Del. Ch. Sept. 2, 2009) (holding that if the trust agreement had paralleled with the trust agreement in Bankers Trust, the trustee would not have been entitled to reimbursement of fees because "Bankers Trust teaches that attorneys' fees incurred by a trustee in pursuing a judicial approval of an accounting should be disallowed to the extent that such fees are attributable to the trustee's efforts to insulate itself from possible surcharges . . . [and to its] desire to receive absolution"; however, in Merrill Lynch, the trustee was entitled to fee reimbursement for the accounting since the trust agreement "expressly authorized" the trustee to condition its' release of the trust assets upon the receipt of a release or judicial approval of its accounting); *See also* DEL. CODE ANN. tit. 12 § 3333 (West 2016) (questions have arisen as to whether 12 *Del. C.* § 3333 opens the door to additional situations outside of the two outlined by the Delaware Supreme Court in Bankers Trust that allow for fee reimbursement from trust assets to trustees when it states "except as provided in the governing instrument, a fiduciary may retain counsel in connection with any claim that has or might be asserted against the fiduciary . . .")
[58] Id. *citing* C.J.S. Attorney and Client § 193 (2016).
[59] Id.
[60] Id.
[61] Id. at 726.
[62] First Union Nat. Bank v. Turney, 824 So.2d 172, 181 (Fla. Dist. Ct. App. Nov. 26, 2001).
[63] Id.
[64] Id. at 191.

waiver invalid since the trustee fraudulently concealed material information when seeking a release from the beneficiary.[65]

2. California. A trustee failed to make a distribution to a beneficiary and the beneficiary filed a petition against the trustee seeking an accounting and distribution of the trust assets.[66] The court ordered the trustee to provide an accounting and to distribute the assets.[67] The trustee offered one-half of the distribution "provided that there [was] no petition forthcoming soon…." and the beneficiary accepted the distribution.[68] The beneficiary moved to compel compliance with the court order requiring the trustee to provide an accounting of the trust estate and the trustee contended that the accounting should be denied because the beneficiary cashed the distribution check.[69] The court held that the beneficiary may challenge the accuracy of the accounting because the trustee may not condition a required distribution on an improper release of liability induced by the trustee.[70]

ix. Beneficiary must have capacity.[71]

1. South Carolina. The court held that a release signed by an aged, ill beneficiary was not binding on his successors.[72]

2. New Hampshire. The trustee petitioned the court for instructions on, among other issues, the liability of a successor trustee for the acts of a predecessor trustee.[73] The court held that sui juris beneficiaries may release the successor trustee from the duty to investigate the conduct of the predecessor trustee.[74]

3. Virtual Representation Permitted. The power of the representative of an infant or insane beneficiary, such as a guardian, to bind the incompetent, depends largely on state statute and the terms of the appointment of the guardian or other fiduciary.[75]

a. Virginia. The court was asked to determine whether an income beneficiary's medical and hospital expenses should be paid out of the trust.[76] The court held that the interests of the unborn contingent remainder beneficiaries were sufficiently similar to the interests of the living contingent remainder beneficiaries to allow the living contingent remainder beneficiaries to represent the unborn contingent remainder beneficiaries under virtual representation.[77]

b. Connecticut. The administrator of a trust filed an action against the former executor for negligence and breach of his fiduciary duty.[78] The children had signed a release absolving the trustee of liability related to the administration of

[65] Id. at 189.
[66] Bellows v. Bellows, 196 Cal.App.4th 505, 512 (Cal. Ct. App. June 9, 2011).
[67] Id.
[68] Id. at 508.
[69] Id. at 509.
[70] Id. at 512.
[71] Bogert, supra, at § 941.
[72] Marchant v. Wannamaker, 180 S.E. 350, 356 (S.C. 1935). *See also* Kinney v. Lindgren, 26 N.E.2d 471 (Ill. 1940) (A trust beneficiary could not ratify the actions of a trustee until she reached majority age).
[73] Spooner v. Dunlap, 180 A. 256, 258 (N.H. June 27, 1935).
[74] Id.
[75] Bogert, supra, at § 941.
[76] Nationsbank of Virginia, N.A. v. Estate of Grandy, 248 Va. 558, 560 (Va. Nov. 4, 1994).
[77] Id. *See also* In the Matter of the Estate of Campbell, 46 Haw. 475, 511 (Haw. May 31, 1963) (Contingent remaindermen may virtually represent a class with identical interests including those who may enter the class at a later date).
[78] Gaynor v. Payne, 261 Conn. 585, 588 (Conn. Sept. 3, 2002).

the trust.[79] The court held that the grandchildren, who did not sign the release and were contingent remainder beneficiaries, could sue the trustee for breach of trust and seek an accounting because they had a vested interest in the trust.[80]

c. Delaware. The Delaware Court of Chancery acknowledged that beneficiaries may virtually represent their issue so long as there is "no material conflict of interest with the represented parties with respect to the particular question or dispute."[81] The court found that the beneficiary's "complete dependence on the monthly distributions from the Trust, coupled with his dependence on [the trustee] emotionally and financially, left him unable to represent the interests of his minor children."[82] The court, therefore, held that the action brought by the beneficiary's children against the trustee could not be barred under the virtual representation statute.[83]

x. Underlying Transaction must be fair and reasonable.

1. New York. Trust beneficiaries filed objections to the trustee's account, claiming the trustee had acted imprudently with respect to certain investments. The trustee filed counterclaims stating that the beneficiaries had executed releases discharging him from the alleged claims.[84] The court held that the trustee's investments were imprudent, and therefore, the releases were not effective in discharging the trustee's liability associated with his imprudence.[85]

xi. Fiduciary must have standing.

1. Delaware. A beneficiary executed a release to the trustee in exchange for receipt of two properties in Rehoboth Beach, Delaware promptly upon termination of the trust.[86] In the release, the beneficiary agreed to "refund any property erroneously distributed to him by the trust."[87] It was later discovered that the deed for one property may have contained an incorrect property description.[88] The trustee sued to return the property to the trust so that the trustee could correct the deed.[89] The Master of the Delaware Court of Chancery concluded that the trust lacked standing to enforce any claims asserted in the petition because the trust "did not suffer an injury in fact."[90]

b. Annual disclosures/reminders (samples):

i. FBAR disclosure - U.S. persons (including trusts) are required to prepare and file the Report of Foreign Bank and Financial Accounts ("FBAR") with the U.S. Treasury for each calendar year if

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[79] Id. at 589.
[80] Id. at 594. *See also* Bogert, supra, at §969 ("Generally, a consent, ratification or release given by one or more, but not all, beneficiaries will not bar claims against the trustee by other beneficiaries").
[81] *Mennen*, 2015 WL 1914599 at *32 *citing* DEL. CODE ANN. tit. 12 § 3547(a) (West 2015).
[82] Id. at *34.
[83] Id. at *35.
[84] Matter of Newhoff, 107 A.D.2d 417, 419 (N.Y. App. Div. Mar. 1985).
[85] Id. *See also* United Towns Bldg. & Loan Ass'n v. Schmid, 92 A.2d 844 (N.J. Super. Ct. Div. 1952) (holding that when a trustee deals with his beneficiary there is a burden on the trustee to show the transaction was fair). *See also* McCormick v. McCormick, 455 N.E.2d 103 (Ill. App. 1983) (holding that release executed after trustee's resignation is subject to attack only for fraud, mutual mistake, or mental incompetence).
[86] William V. Ehrlich, Jr., Trustee of the William V. Ehrlich Trust U/W/D May 5, 1977, as Amended v. Jeffrey Ehrlich and Vinn, LLC, 2016 WL 3980984, at *2 (Del. Ch. July 25, 2016).
[87] Id.
[88] Id.
[89] Id.
[90] Id. at *3.

the trust has a direct or indirect financial interest in one or more foreign financial accounts if the aggregate balance of all reportable accounts exceeds $10,000. There are significant penalties for failure to comply with FBAR requirements. As Trustee, XXX Trust Company of Delaware, will file the FBAR by June 30th on behalf of the trust if at any time during the prior calendar year the trust had a financial interest in a foreign financial account. As the investment adviser, you have responsibility for providing us information about all accounts owned by the trust and for complying with the FBAR regulations that are applicable to you.

ii. OFAC disclosure – As the investment adviser, you have the responsibility to ensure that you do not cause the Trust to conduct any unlawful transactions, with, on behalf of, or for the benefit of an individual or entity that is, or is owned or controlled by Persons that are (i) the subject of any sanctions administered or enforced by the U.S. Department of the Treasury's Office of Foreign Assets Control, the U.S. Department of State, or other relevant sanctions authority (collectively, "Sanctions"), or (ii) located, organized or resident in a country or territory that is, or whose government is, the subject of Sanctions.

SAMPLE INVESTMENT DIRECTION LETTER

_____ , 2016

Trust Company
Address

Re: **Trust Name (the "Trust")**

To whom it may concern:

In my capacity as _____ of the _____ (the "Trust"):

1. I hereby direct Trust Company, solely in its capacity as Trustee of the Trust and not in its individual capacity, to take the following action(s) with respect to _____, LLC (the "LLC"):

   a. Accept the assignment of a _____% interest in the LLC by executing the attached _____; and

   b. Execute the attached _____ Agreement of the LLC (the "LLC Agreement").

2. I understand and agree that:

   a. I shall direct Trust Company as to all matters involving the removal of the Manager of the LLC, the appointment of a successor Manager of the LLC, and any and all other matters in connection with the business and affairs of the LLC over which the Trust is entitled or has the authority to act under the LLC Agreement or applicable law;

   b. The Trust shall never be appointed as successor Manager of the LLC;

   c. Trust Company will carry the Trust's interest in the LLC (the "Interest") on the books of the Trust at the value specified by me to Trust Company from time-to-time, but if I do not specify to Trust Company the value of the Interest, then Trust Company will carry the Interest on the books of the Trust at $1 unless Trust Company has been informed of the value of the Interest by another person, in which case Trust Company may carry the Interest on the books of the Trust at that value;

   d. Trust Company may ask me about the value of the Interest each year (and perhaps more frequently than once per year); and

   e. Under Delaware law, I have the duty to provide information to Trust Company about the LLC and the Interest (including the value of the Interest) when requested to do so by Trust Company.

3. I hereby inform you that:

   ☐ The current value of the Interest is $_____.

   OR

☐ I am uncertain about the current value of the Interest, but the value of the Interest was $_____ as of _____.

4. If I have not completed any of the blank lines in paragraph 3 above, then I represent that I am uncertain about the current value of the Interest and I do not have information about the value of the Interest within the last three years.

I hereby represent and warrant that I have reviewed the LLC Agreement and that to the best of my knowledge, information, and belief, the representations and warranties contained therein are true and correct in all respects.

Sincerely,

[Insert name]
[Insert title]

_____, 2016

Trust Company
Address

Re: **Trust Name (the "Trust")**

To whom it may concern:

In my capacity as _____ of the _____ (the "Trust"):

5. I hereby direct Trust Company, solely in its capacity as Trustee of the Trust and not in its individual capacity, to take the following actions with respect to a subscription for an interest in _____, LLC (the "LLC") in the amount of $_____ (the "Total Subscription Amount"):

   c. Execute the following attached documents (collectively, the "Documents"):

      i. Subscription Agreement;
      ii. Operating Agreement of the LLC (the "LLC Agreement"); and
      iii. IRS Form W-9.

   d. Transmit the executed Documents to _____; and

   [IF A SINGLE TRANSFER, use paragraph c below; IF MULTIPLE TRANSFERS, use paragraph d below, which you may need to modify to fit the circumstances.]

   e. Wire the Total Subscription Amount from the [describe the account] in accordance with the following instructions:

   [Insert instructions]

   f. Wire up to the Total Subscription Amount from the [describe the account] pursuant to instructions provided to you by _____ regarding the timing and amounts.

6. I understand and agree that:

   f. I shall direct Trust Company as to any and all matters in connection with the business and affairs of the LLC over which the Trust is entitled or has the authority to act under the LLC Agreement or applicable law;

   g. The Trust shall never be appointed as successor Manager of the LLC;

   h. Except as otherwise provided in subparagraph d or e below, Trust Company will carry the Trust's interest in the LLC (the "Interest") on the books of the Trust at the Total Subscription Amount (or at such portion of the Total Subscription Amount as is transferred by the Trust, if lower than the Total Subscription Amount).

i. Except as otherwise provided in subparagraph e below, Trust Company will carry the Interest on the books of the Trust at the value specified by me to Trust Company plus the amount of any portion of the Total Subscription Amount as is transferred by the Trust after the effective date of the value so specified.

j. Trust Company will carry the Interest on the books of the Trust at the value specified on the most recent LLC statement or other LLC communication provided to Trust Company plus the amount of any portion of the Total Subscription Amount as is transferred by the Trust after the effective date of the value so specified, except to the extent that I have specified to Trust Company a more recent value of the Interest.

k. Trust Company may ask me about the value of the Interest each year (and perhaps more frequently than once per year); and

l. Under Delaware law, I have the duty to provide information to Trust Company about the LLC and the Interest (including the value of the Interest) when requested to do so by Trust Company.

I hereby represent and warrant to Trust Company that:

- I have reviewed the Documents, any documents referred to therein, and any exhibits, schedules, annexes, or the like to the Documents, and that to the best of my knowledge, information, and belief, the representations, warranties, certifications, and the like contained therein are true and correct in all respects, including but not limited to the representations that the Trust qualifies as an "Accredited Investor" and "Qualified Purchaser" as those terms are defined in the Subscription Agreement;

- I am familiar with the assets and liabilities of the Trust and their values, and I have such knowledge and experience in financial and business matters so that I am capable of evaluating the merits and risks of investing in the LLC;

- It is my intention that the Trust grant the powers of attorney and indemnifications, if any, contained within the Documents, with the understanding that any such indemnifications shall be limited solely to the assets of the Trust and not Trust Company's individual assets; and

- Such options or selections as are available in the Documents have been made or not made, as the case may be, as I have deemed appropriate.

Sincerely,

[Insert name]

[Insert title]