

DON'T TREAD ON ME

How Delaware Courts Review Trustee Discretion

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In a practical sense, trustees assess their potential business risk whenever they take a discretionary action. In other words: “What is the risk that an interested party will sue us for exercising this discretion?” The short answer to this question is that a Delaware court should not overturn a trustee’s exercise of sole and absolute discretion granted under the governing instrument unless it can be shown that in exercising such discretion the trustee acted dishonestly or with an improper motive, or failed to exercise its own judgment. This answer is derived from recent case law and a hidden gem found in Delaware’s trust statutes.

Look To Restatement Second Not Restatement Third

Under Delaware law, the trustee’s exercise of discretion may be overturned by a court if there is evidence of an abuse of discretion. Section 3315(a) of Title 12 of the Delaware Code (effective August 1, 2008) provides: “Where discretion is conferred upon the fiduciary with respect to the exercise of a power, its exercise by the fiduciary shall be considered to be proper unless the court determines that the discretion has been abused within the meaning of § 187 of the Restatement (Second) of Trusts, not §§ 50 and 60 of the Restatement (Third) of Trusts.”¹

Section 3315 makes an unusual and interesting distinction between the Restatement (Second) of Trusts (“Restatement Second”) and the Restatement (Third) of Trusts (“Restatement Third”) which invites further examination. The Section instructs us to disregard the standard set forth in the more recently adopted Restatement and apply the older Restatement Second standard instead. As it turns out, the legislature has done this to make it clear that when a trustee has absolute discretion not limited by a standard, the court should not evaluate the reasonableness of the exercise of discretion but rather, it should limit the analysis to whether the trustee acted dishonestly or with an improper motive.

Section 187 of the Restatement (Second) of Trusts (“Restatement Second”) provides that “[w]here discretion is conferred upon the trustee with respect to the exercise of a power, its exercise is not subject to control by the court, except to prevent an abuse by the trustee of his discretion.”²

Comment i of Section 187 of the Restatement Second provides that where the trustee’s discretion is not limited by a standard, then the court will only interpose if the trustee acts dishonestly or from some improper motive.

Comment j of Section 187 of the Restatement provides that the settlor of a trust may manifest an intention that the trustee's discretion need not be exercised reasonably, even where there is a standard by which the reasonableness of the trustee's conduct may be judged, by the inclusion of a provision in the governing instrument that the trustee shall have "absolute" or "unlimited" or "uncontrolled" discretion.³

Section 60 of the Restatement Third only discusses an abuse of discretion by a trustee in the context of whether discretionary distributions can be compelled by a beneficiary's transferee or creditors. Section 50(2) of the Restatement Third, along with its comments, offers a court greater leeway than Restatement Second to determine that a power exercised by a trustee constitutes an abuse of discretion. Specifically, Section 50(2) of the Restatement Third provides that "the benefits to which a beneficiary of a discretionary interest is entitled, and what may constitute an abuse of discretion by the trustee, depend on the terms of the discretion, including the proper construction of any accompanying standards, and on the settlor's purposes in granting the discretionary power and in creating the trust."⁴

Comment b of Section 50 of the Restatement Third sets forth a series of requirements and standards for reviewing discretion. It provides in part:

"A court will not interfere with a trustee's exercise of a discretionary power when that exercise is reasonable and not based on an improper interpretation of the terms of the trust.... On the other hand, a court will not permit abuse of discretion by the trustee. What constitutes an abuse of discretion depends on the terms of the trust, as well as on basic fiduciary duties and principles. Of particular importance are the purposes of the power and the standards, if any, applicable to its exercise and the extent of the discretion conferred upon the trustee. Relevant fiduciary principles include (i) the general duty to act, reasonably informed, with impartiality among the various beneficiaries and interests and (ii) the duty to provide the beneficiaries with information concerning the trust and its administration.... Absent language of extended (e.g., "absolute" or "uncontrolled") discretion, a court will...intervene if it finds the payments made, or not made, to be unreasonable as a means of carrying out the trust provisions.... It is not necessary...that the terms of the trust provide specific standards in order for a trustee's good faith decision to be found unreasonable and thus to constitute an abuse of discretion."

Thus, Section 3315(a) expressly rejects the additional requirements and standards described above in Section 50(2) of the Restatement Third, in favor of the more restricted standard of review found in Section 187 of the Restatement Second. Consequently, a trustee who exercises its power in an honest and good faith manner, and did not act dishonestly or with an improper motive, should not be deemed to have abused its discretion under Delaware trust law.

It Must Be The Trustee's Decision

"One final observation bears noting. If the Trustee simply abdicates its duties and acts solely upon the request of someone else, then this potential failure to exercise any discretion concerning the action could result in an abuse of discretion.⁵ In other words, the Trustee cannot abandon its discretion and follow the suggestion or instructions of another. Additionally, consistent with the analysis in the Campbell decision, the trustee should be sure to follow its established policies and procedures for making such decisions.



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Notes

¹ Several Delaware cases decided prior to the enactment of Section 3315 address the abuse of discretion standard. They generally hold that in analyzing whether a trustee properly has exercised its discretionary powers, a Delaware court will not substitute its own judgment for that of the trustee, unless the court finds that the trustee acted in bad faith or in an arbitrary or unreasonable manner. In the Matter of Barker Trusts, C.A. 20455, V.C. Lamb (Del. Ch. Feb. 7, 2005) (Mem. Op.); See also, Wilmington Trust Company v. Coulter, 200 A.2d 441 (Del. 1964). It remains to be seen how the Delaware court may, if at all, conclude that Section 3315 overrides the standard expressed in those cases.

² RESTATEMENT SECOND OF TRUSTS § 187 (1959); See Merrill Lynch Trust Company, FSB v. Mary F.C. Campbell, et al., C.A. 1803-VCN, V.C. Noble (Del. Ch. September 2, 2009) (Mem. Op.) at 23.

³ For this reason, it is advisable to ensure that the governing instrument consistently grants "sole and absolute discretion."

⁴ Restatement Third of Trusts § 50(2) (2001). Section 50(1) of Restatement Third provides that "[a] discretionary power conferred upon the trustee to determine the benefits of a trust beneficiary is subject to judicial control only to prevent misinterpretation or abuse of the discretion by the trustee."

⁵ See Campbell at 23.