

## Mennen v. Wilmington Trust Company, George Jeffrey Mennen and Owen J. Roberts as Trustees

C.A. No. 8432

### Master LeGrow (Del. Ch. April 24, 2015) (Master's Final Report)

The Morris Nichols' Tax, Trusts and Estates group previously published a case alert analyzing Master LeGrow's draft Master's Report dated December 8, 2014 (the "Draft Report") in the Mennen case pertaining to a co-trustee's liability for certain investment decisions. In the Draft Report, the Delaware Court of Chancery (the "Court") entered a judgment against George Jeffrey Mennen ("Jeff"), as the co-trustee of a trust for Jeff's brother, John, in the amount of \$72,448,299 plus interest. This judgment was based on the Court's conclusion that Jeff engaged in an extensive pattern of bad faith with respect to managing the trust's investments over a significant period of time. The analysis of the Draft Report is available at [http://www.morrisnichols.com/assets/html/documents/MorrisNicholsAlert\\_Mennen\\_1302015.pdf](http://www.morrisnichols.com/assets/html/documents/MorrisNicholsAlert_Mennen_1302015.pdf).

Exceptions to the Draft Report were submitted to the Court on February 13, 2015. On April 24, 2015, Master LeGrow issued a Master's Final Report (the "Final Report") entering a judgment against Jeff in the amount of \$96,978,299.93 plus pre-judgment interest of 7.75% compounded quarterly. Notably, the Final Report contains some additional insight regarding the Court's analysis of the definition of "good faith" and the application of Delaware's virtual representation statute, 12 Del. C. § 3547 ("Section 3547"). The parties in Mennen may take exceptions to the Final Report in accordance with Court Rule 144.

### Definition of Good Faith

As noted in our prior case alert, the trust agreement exculpated the co-trustee from losses to the trust estate so long as the co-trustee acted in "good faith." In the Draft Report and Final Report, the Court found that Jeff was liable because he acted in bad faith (which in the Court's view was synonymous with the absence of good faith).

In the Final Report, the Court briefly addressed Jeff's additional argument that the statutory definition of good faith applies only to the use of that term in the Delaware trust code, and not when the same term is used in trust agreements. The Court rejected Jeff's argument as inconsistent with the Delaware trust code and the Court's prior precedent. The Court noted that, if Jeff's position was accepted, the Court may potentially be required to apply two different standards of good faith to a trustee's actions.

### Virtual Representation Under Section 3547

As noted in our prior case alert, the Court concluded that the claims brought against Jeff were not barred by laches because John could not virtually represent the interests of his minor children, who were the other beneficiaries of the trust. This conclusion was based on the Court determining that John had a material conflict of interest with his children when the challenged investment decisions were made by Jeff. In the Final Report, the Court clarified its analysis and presented two additional arguments made by Jeff regarding John's ability to virtually represent his children under Section 3547.

In the Draft Report and Final Report, the Court found that John placed nearly complete emphasis on receiving income from the Trust, without any apparent regard for capital growth or long-term stability of the Trust. In the Final Report, the Court indicated that this fact alone was sufficient evidence of a material conflict of interest for purposes of Section 3547.

First, Jeff presented the additional argument that the Court should apply an objective rather than a subjective test to determine whether a material conflict exists between a putative representative and the other beneficiaries. More specifically, Jeff espoused the theory that if a person of ordinary intelligence could have virtually represented his minor children under similar circumstances, the Court should not consider the specific relationship between the parties before it.

The Court rejected this argument in the Final Report for a few reasons. First, the Court stated that if Jeff's argument was the result that the legislature intended when enacting and amending Section 3547, the legislature could have simply defined what constitutes a material conflict and what does not. Second, the Court stated that an objective standard would be ill-suited to address the various relationships between parties that appear before the Court in trust matters. According to the Court, the likely result of applying Jeff's argument to the Court's Section 3547 analysis would be to unduly eliminate virtual representation in some cases where no actual conflict exists, while permitting virtual representation when the factors in a particular case demonstrate that a conflict plainly existed. Finally, the Court construed certain recent statutory amendments to Section 3547 as showing that the legislature intended that the Court rely on subjective factors. The Court indicated that reliance on subjective factors would be the only way to overcome a presumption of a conflict under Section 3547.

Jeff also presented the additional argument that the reference in Section 3547 to a "material conflict ... with respect to the particular question or dispute" means that John did not have a conflict with his minor children because his interests are aligned with his children's in the litigation. The Court concluded that this reading ignores the substance of Section 3547 and, instead, construed that language to mean that the interests of John and his minor children must be aligned at the time the alleged representation occurred. The Court continued to state that the issue of virtual representation as it applies to a laches analysis is not whether the parties' interests are aligned in the action in which a laches defense is raised, but instead whether the interests were aligned at the time the representation allegedly occurred.

## Conclusion

Although the Final Report is subject to further exceptions and review by the Court, it was significant in its own right. Most saliently, the Court rejected several arguments offered by Jeff and, in doing so, provided further analysis of the concept of a "material conflict of interest" under Section 3547 and the statutory definition of "good faith".

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