Designated Representatives:

Sending Trusted Individuals to the Front Lines

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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.

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.

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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 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.

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Notes:
1- 12 Del. C. § 3547