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by
Vincent C. Thomas, Esq.
Young Conaway Stargatt & Taylor, LLP

“Can the Non-Judicial Settlement Agreement Statute be used to modify a trust?”

A Trustee’s Modification Toolbox: Does it Really Include Non-Judicial Settlement Agreements?

Effective August of 2013, the Delaware legislature adopted another non-judicial tool for trusts, the Delaware non-judicial settlement agreement statute (the “NJSA Statute”). See 12 Del C. § 3338. The NJSA Statute generally permits all interested persons (i.e., beneficiaries and the trustees) to enter into a settlement agreement with respect to any matter involving a trust so long as it does not violate a material purpose of the trust and includes terms and conditions that could be properly approved by the Delaware Court of Chancery. Since the adoption of the NJSA Statute, the so called million dollar question has been: Can the NJSA Statute be used to modify a trust? While at first blush the NJSA Statute would seem to permit the modification of a trust, a closer look at the NJSA Statute may suggest otherwise.

In adopting trust legislation, the Delaware legislature has traditionally considered input from the Estates and Trusts Section of the Delaware State Bar Association (“DSBA”). In early 2013, the Estates and Trusts Section of the DSBA and the executive committee of the DSBA approved a draft non-judicial settlement statute (the “Original Statute”) that by its terms specifically permitted modification of a trust. The Delaware legislature rejected the Original Statute in favor of the NJSA Statute which is modeled off of the Uniform Trust Code Section 111 (“UTC 111”). Reasonable minds could differ about why the Delaware legislature rejected the Original Statute and what UTC 111 (which is identical to the NJSA Statute) truly permits. The reality is that the Delaware legislature would have rejected the NJSA Statute if it specifically permitted modification of a trust within subpart (d) which demonstrates the clear intent behind the NJSA Statute. Moreover, the Delaware Chancery Court may share the view that the NJSA Statute does not permit trust modification and there is no case where the Delaware Chancery Court approved a non-judicial settlement agreement that modified a trust.

Even assuming the NJSA Statute allows for modification of a trust, use of the NJSA Statute carries far more risk than modification of a trust via merger or decanting accompanied by releases signed by the beneficiaries. Unless the Delaware trustee intends to seek approval of the non-judicial settlement agreement from

the Delaware Court of Chancery in accordance with subpart (e) of the NJSA Statute, how can the Delaware trustee or beneficiaries ever be certain that the modifications set forth in the non-judicial settlement agreement do not violate a material purpose of the trust and do not include terms and conditions that the Delaware Chancery Court would not approve both as required by the NJSA Statute? Fortunately, neither the Delaware merger statute nor decanting statute contain such uncertain requirements. In fact, the Delaware merger statute has one requirement (i.e., no material change in the beneficial interests) and the Delaware decanting statute has a few concrete requirements with the primary one being the trustee’s authority to invade the principal of the trust.

Some will argue that the NJSA Statute is preferable because it doesn’t involve an act of trustee discretion like merger or decanting. First, the act of trustee discretion in mergers and decanting can be mitigated with releases from the beneficiaries. Second, should there be an issue with an NJSA, a disgruntled beneficiary (e.g., perhaps a minor who was virtually represented with the NJSA) certainly would bring suit against the trustee with deep pockets and allege that the NJSA would not have been enforceable but for the trustee’s agreement to the same. Put simply, the requirement of the trustee to agree to the non-judicial settlement agreement is for practical purposes somewhat akin to an act of trustee discretion.

In sum, in all cases, given the uncertainty surrounding both the authority to use the NJSA Statute for trust modification and the requirements within the NJSA Statute, merger or decanting accompanied by beneficiary releases will be a better non-judicial option to accomplish a trust modification. Delaware trustees should accordingly refuse to use the NJSA Statute to modify trusts, and if insisted upon, require that non-judicial settlement agreement be approved by the Delaware Court of Chancery in accordance with subpart (e) of the NJSA Statute.

The content of this column is based largely upon a more comprehensive article and presentation. For further information on this topic, please contact the author.