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Trust Law Update



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Guarantee of Loans by a Trust: Considerations for the Trustee

Oftentimes, trustees of Delaware trusts are asked to enter into guarantee agreements on behalf of the trust to guarantee loans for the benefit of trust beneficiaries or in connection with entities that may be owned by the trust. This column provides a non-exhaustive checklist of items for the trustee to consider prior to entry into any guarantee agreements on behalf of the trust.

I. Power to Guaranty

First, the trustee should determine if the trust instrument specifically authorizes or prohibits a loan guaranty. If the trust instrument addresses the issue, the trustee should strictly comply with the terms of the trust instrument. If the trust is silent, as is oftentimes the case, the trustee will need to comply with 12 Del. C. § 3325(19). Notably, 12 Del. C. § 3325(19), permits a guaranty ONLY if it is (i) made for investment purposes; (ii) made in lieu of a distribution amount that could have been made currently to or for such beneficiary under the terms of the governing instrument, not made in excess of such amount, and the fiduciary creates a reserve for the potential liability; or (iii) made to or for the benefit of another trust of which such beneficiary is also a beneficiary, provided the requirements of (ii) above are also satisfied.

II. Affiliates

If the loan to be guaranteed is from an affiliate of the trustee, the trustee must ensure compliance with any terms in the trust instrument regarding affiliated investments, applicable Delaware statutes regarding affiliated investments, and the trustee's common law fiduciary duties (e.g., duty of loyalty).

III. Guarantee Terms

The trustee should cautiously review the guarantee agreement for traps for the unwary, including, but not limited to:

a. Joint and Several Guaranty Agreements. Suppose the trust owns a 50% interest in an LLC. LLC is borrowing money and the lender has requested that the trust and the other 50% owner (such owner not being a current trust beneficiary) jointly and severally guarantee the loan. Since the loan theoretically benefits a non-beneficiary, should the guarantee by the trust be limited to 50% of the loan?

b. Representations, Warranties, and Covenants. Many guarantee agreements require the guarantor to take additional actions that may be governed by different provisions in the trust instrument or Delaware Trust Act. For example, guarantee agreements often require the guarantor to pledge assets as collateral or restrict the guarantor from transferring assets. The trustee will generally need to ensure that the trust instrument or Delaware law authorizes such additional acts or requirements.

IV. Consider Bootstrap Protections

If there is any uncertainty regarding the trustee's power to enter into the particular guaranty, the trustee could consider a number of protections. For example, if the trust is revocable or otherwise amendable (e.g., trust protector amendment power), a provision could be added specifically authorizing the entry into the particular guarantee agreement. The trustee could also consider resolving any ambiguity or having the beneficiaries direct the trustee to enter into the guarantee agreement pursuant to a non-judicial settlement agreement under 12 Del. C. §§ 3338(d)(1) or (3). Lastly, the trustee should always consider seeking a release from liability for entry into the guarantee agreement under 12 Del. C. § 3588.