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Know Your Limitations

The Importance of
Statutes of Limitation
for Trustees



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The Importance of Statutes of Limitation for Trustees

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In the fiduciary world, risks are routinely managed and rarely eliminated. Every action or inaction carries risk, and any trustee who fails to address these risks won't be in business for long. To mitigate risk, trustees most often rely upon release or consent, adjudication or waiting until claims are otherwise precluded by law. Where the first two options are unfeasible, impossible or undesirable, a trustee should be mindful of how long its exposure endures before a risk can be duly written off. To avoid missteps, or worse, inadvertently covering over (or diving into) a pitfall, professionals must have a strong grasp of the various limitations periods applicable to claims of beneficiaries against trustees of Delaware trusts. This year, a critical new limitations period has been added under Delaware law.¹

Claims by Beneficiaries – 2 Years, 3 Years, 5 Years or 120 Days?

Section 3585 of Title 12 of the Delaware Code generally governs the time in which a beneficiary must bring a claim against the trustee of a Delaware trust for breach of trust.² In most instances, the statute of limitations is two years after the beneficiary was sent a report that “adequately disclosed the facts constituting a claim.”³ In 2017,⁴ however, an important exception was added for a trustee who ceases to serve, whether due to resignation, removal, termination or any other reason. If the outgoing trustee sends a report notifying a beneficiary that the trustee has ceased to serve, adequately disclosing the facts constituting a claim and notifying the beneficiary of the time limit, the beneficiary has 120 days in which to initiate a legal proceeding against the outgoing trustee.⁵

This 120-day limit is a powerful tool. It allows a trustee to end a trust relationship and relinquish the trust assets without fear of liability to the beneficiaries far down the road. It also puts the onus on an aggrieved beneficiary to take decisive action – reviewing the report, finding and engaging counsel, and initiating a lawsuit – within a brisk-but-reasonable four months. By then, the trustee will have a clear picture of where it stands, and clarity in forecasting is a boon to any organization.

If neither the two-year period nor the 120-day period applies, such as when the beneficiaries have not been provided a report adequately disclosing the facts constituting a claim, the three-year statute of limitations for personal actions under Section 8106 of Title 10 of the Delaware Code may apply to claims of beneficiaries.⁶ Unlike the deadlines in Section 3585, this three-year period runs from the event giving rise to the cause of action.⁷ This limitations period may be suspended, however, based on circumstances, such as where the event in question is inherently unknowable or where the beneficiary reasonably relies on the competence and good faith of a fiduciary.⁸ As these circumstances are frequently present in trust cases, a trustee should not count on this limitations period as a bar to claims.⁹

In any event, Section 3585 provides a backstop limitations period of five years. If neither the two-year period nor the 120-day period of Section 3585(a) applies, a beneficiary has five years to initiate a proceeding against the trustee, beginning from the earlier of the date the trustee ceases to serve or the date when the beneficiary’s interest in the trust terminates.¹⁰

It is important to bear in mind that, for each of the limitations periods under Section 3585, the time to bring a claim does not run from the date of the actual event giving rise to the claim.¹¹ This is in sharp contrast to most other areas of the law, where, for example, the statute of limitations on a breach of contract claim generally runs from the date of the breach, or the time to bring a personal injury claim generally runs from the date of the injury.¹² In the case of a trustee who does

not provide regular reports of its activity, or whose reports are not sent to certain beneficiaries, decades could pass between the time of the act causing the alleged harm and the lawsuit seeking to hold the trustee liable. This underscores the importance of regular and thorough reporting.

What Constitutes a “Report”?

Whether two years or 120 days, the limitations period runs from the time the trustee sends a beneficiary a “report adequately disclosing the facts constituting a claim.”¹³ A report adequately discloses the facts constituting a claim if it “provides sufficient information so that the beneficiary knows of the claim or reasonably should have inquired into its existence.”¹⁴

In the case of claims pertaining to investment or disbursements, detailed financial statements would ordinarily seem sufficient to satisfy the criteria of a “report.” But beneficiaries may complain of a great many things that never appear on a financial statement, which should lead a trustee to evaluate when and how it communicates with beneficiaries. Examples include a trustee’s act of pledging or otherwise encumbering trust assets, which may not be evidenced on statements, or the failure to make appropriate tax elections, or taking direction from an adviser that may be beyond the scope of that adviser’s authority. Even the act of resigning itself could engender liability if it causes the trust to lose its Delaware situs in a way that damages the interests of the beneficiaries.¹⁵

In the ordinary, ongoing course of business, a trustee should exercise discretion over how much it discloses to beneficiaries, and to whom and when the disclosures are made. After all, running the statute of limitations is only one consideration when dealing with beneficiaries and maintaining a relationship over a term of years. But upon resignation, removal, termination of the trust or some other event that causes a trustee to cease to serve, a trustee should open the kimono and provide as much information as possible about the administration of the trust, financial and otherwise. Remember, the 120-day limitations period for an outgoing trustee does not apply to all claims; rather, only those claims for which the trustee’s report adequately disclosed the underlying facts. Accordingly, more information is better.

An important caveat, however, may be derived from the case of *Merrill Lynch Trust Co. v. Campbell*.¹⁶ In that now-vacated decision,¹⁷ the trustee sought judicial approval for its conduct, expressly putting at issue its investment performance during the entirety of its tenure, which stretched back more than two years.¹⁸ At the same time, the trustee sought to partially bar the beneficiary’s counterclaims that the trustee mishandled the trust’s investment by asserting the 2-year statute of limitations¹⁹ applied in light of the beneficiary’s receipt of sufficient reports.²⁰ The Court found that the trustee’s act of voluntarily submitting its conduct for review going back more than two years effectively opened up the statute of limitations.²¹

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Consequently, the lesson for trustees is not to place otherwise time-barred claims of beneficiaries back in play. Whether submitting an accounting to the Court for approval or sending a final report to the beneficiaries upon resignation, removal or termination, a trustee should not go back more than two years if the trustee believes its earlier conduct was already adequately disclosed to the beneficiaries.

Limitations on the Limitations Period

It is worth noting that the limitations periods set forth in Section 3585 may apply differently to different beneficiaries depending on circumstances. Sending reports to some beneficiaries and not others may not run the limitations period for those not receiving reports. A competent adult beneficiary entitled to information about the trust will not be bound by the limitations period unless and until he or she is sent a report.²² Thus, if the trustee has a policy of sending reports only to current beneficiaries, the 2-year limitations period will not run against competent adult remainder beneficiaries,²³ meaning their claims, if any, would remain open-ended.

In the case of a minor, unborn or unascertained beneficiary, he or she will be deemed to have been sent a report if sent to a person who may virtually represent the interests of that beneficiary under 12 Del. C. § 3547.²⁴ In the case of a beneficiary, competent or not, represented by a designated representative under 12 Del. C. § 3303(d), he or she will be deemed to have been sent a report if sent to the designated representative.²⁵

Lastly, the limitations periods set forth in Section 3585 may be tolled where the report in question was a product of fraud or contained material misrepresentations, and do not apply to bar a beneficiary's claim to recover for fraud or misrepresentation related to the report.²⁶

Takeaways for Trustees

In order to keep the 2-year limitations period rolling at all times, a trustee should send reports on a regular and frequent basis. For maximum coverage, those reports should be comprehensive, and ideally should be sent to every adult beneficiary and designated representative, regardless of the nature of the beneficiary's interest. This goes doubly when a trustee ceases to serve, but a trustee should avoid re-disclosing information already reported to a beneficiary that otherwise time-bars related claims. Keeping an eye towards applicable statutes of limitation helps the savvy trustee steer clear of trouble.



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Notes

- 1 - Not addressed in this article are the applicable limitations periods for claims of persons other than beneficiaries, such as co-fiduciaries, creditors and other third parties.
- 2- Generally, the Court of Chancery is not strictly bound by a statute of limitations, and instead applies the doctrine of laches to determine whether an action is filed timely. *In Matter of Thomas Lawrence Reeves Irrevocable Tr. Under Agreement Dated Feb. 26, 1997*, 2015 WL 1947360 at *7 (Del. Ch. Apr. 29, 2015), adopted *sub nom. In re Thomas Lawrence Reeves Irrevocable Tr.* (Del. Ch. July 2, 2015). The doctrine serves as an equitable defense against a plaintiff who unreasonably delays pursuing a claim after learning that his or her rights were infringed upon. *Id.* However, there are occasions when a statute of limitations may apply directly to a claim filed in the Court of Chancery, and Section 3585 may such be an instance. *Id.* at n. 73. See also *Kahn v. Seaboard Corp.*, 625 A.2d 269, 271-72 (Del. Ch.1993) ("statutes of limitation could apply directly to causes in Chancery of every sort. It is within the constitutional power of our legislature to do so"). Regardless, Section 3585 would appear to set the presumptive period of what constitutes an unreasonable delay on the part of a beneficiary in bringing a claim for purposes of a laches analysis. *Reeves* at *7.
- 3- 12 Del. C. § 3585(a)(1).
- 4- 81 Del. Laws, c. 149.
- 5- 12 Del. C. § 3585(a)(2).
- 6- See *Reeves*, 2015 WL 1947360 at *7, *supra* n. 3.
- 7- 10 Del. C. § 8106.
- 8- *In re Dean Witter Partnership Litigation*, 1998 WL 442456 at *5 (Del. Ch. July 17, 1998).
- 9 -See, e.g., *In re the Volftsun/Landy Trust Litig.*, C.A. No. 4653-VCL (Del. Ch. Oct. 24, 2012) (TRANSCRIPT).
- 10- 12 Del. C. § 3585(d).
- 11- Moreover, Section 3585 does not cover all beneficiary claims against trustees. For example, a beneficiary may bring claims against a trustee for something other than breach of trust, such as a removal action under 12 Del. C. § 3327(2) or (3), which would not be subject to the time limitations of 12 Del. C. § 3585. See *du Pont v. Wilmington Trust Co.*, 2017 WL 4461132 (Del. Ch. Oct. 6, 2017). See also *Merrill Lynch Trust Co., FSB v. Campbell*, 2007 WL 2069867 (Del. Ch. July 11, 2007), vacated by *Campbell v. Merrill Lynch Trust Co., FSB*, 12 A.3d 1153 (Del. Feb. 3, 2011) (suggesting that a beneficiary's claims of fraud and negligent misrepresentation against a trustee surrounding the circumstances of the trust's creation are governed by the 3-year limitations period of 12 Del. C. § 8106).
- 12- The apparent rationale is that a trustee, as a fiduciary, owes the highest duty to a beneficiary, much higher than the duties between contracting parties or colliding motorists.
- 13- 12 Del. C. § 3585(a). However, it is important to note that the limitations period with respect to a claim always ends on the



earliest to occur of the expiration of two years or 120 days, as applicable, or the date on which the claim was otherwise precluded by adjudication, release, consent, limitation or pursuant to the terms of the governing instrument. *Id.*

14- 12 *Del. C.* § 3585(b).

15- The damage could be particularly acute in the case of a Delaware asset protection trust, or where the situs defaults to a state that then taxes the trust's income.

16- 2007 WL 2069867, *supra* n. 12.

17- See *Campbell*, 12 A.3d 1153, *supra* n. 12. Although the Delaware Supreme Court vacated this 2007 opinion and order of the Court of Chancery entirely, the Supreme Court appeared primarily concerned with the applicability of a laches defense to claims regarding the formation of the trust. *Merrill Lynch Trust Co., FSB v. Campbell*, 2011 WL 383928 (Del. Ch. Jan. 24, 2011). There is no indication in the record that the Supreme Court found fault with the Court of Chancery's reasoning as to why the trustee's statute of limitations defense must fail.

18- *Campbell*, 2007 WL 2069867 at *4.

19- 12 *Del. C.* § 3585(a)(1).

20- *Campbell*, 2007 WL 2069867 at *4.

21- *Id.*

22- 12 *Del. C.* § 3585(c)(1).

23- This could include even takers in default of the exercise of a power of appointment. See *Estate of Tigani*, 2016 WL 593169 at *14 (Del. Ch. Feb. 12, 2016).

24- 12 *Del. C.* § 3585(c)(2).

25- 12 *Del. C.* § 3585(c)(3).

26- 12 *Del. C.* § 3585(e).