IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IMO: THE IRREVOCABLE ASSET PROTECTION TRUST OF HENRY C. ROHLF, Dated July 9, 2004	)))	C.A. No. 4464-MG

MEMORANDUM OPINION

Submitted: July 6, 2011
Decided: July 12, 2011

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Matthew M. Carucci, Esquire, of Carucci Butler, LLC, Wilmington, Delaware; Attorney for Respondents

GLASSCOCK, Vice Chancellor.

This matter involves a supposed "asset protection trust" ("Henry's trust") settled by and for the benefit of respondent, Henry Rohlf. Rohlf was the remainder beneficiary, and trustee, of his mother's estate and trust ("Mother's trust"). The petitioner in this action, BNY Mellon Trust of Delaware ("BNY") held a demand note representing a several hundred thousand dollar loan BNY had made to Rohlf, secured by the assets in Mother's trust. After his mother's death in 2003, the assets of Mother's trust passed to Rohlf. The outstanding loan balance due BNY at that time was $368,884.14. Rather than use the assets of Mother's trust to pay off the BNY loan, Rohlf set up the trust at issue here, Henry's trust, to receive the assets of his mother's estate. The purpose of Henry's trust was to protect the assets from Rohlf himself, and from his potential creditors, since Rohlf had a history of bad investments.[1] BNY was the co-trustee of the trust, along with Rohlf's lawyer, Joseph H. Sweeney.[2] Once the trust was funded, Rohlf and his domestic partner, co-respondent Edgar Mitchell, obtained another line of credit from BNY[3] on May 10, 2005 for $570,000, to pay off the pre-existing loan secured by the assets of Mother's trust, as well as to allow the respondents to invest in the renovation of their home. This $570,000 loan proved insufficient for the respondents' purposes; they

[1] As will become clear, as an "asset protection trust," Henry's trust was a notable failure.

[2] Sweeney resigned as a trustee of Henry's trust effective January 20, 2009. Petition for Instruction Exhibit B.

[3] Under the terms of the Trust Agreement, BNY was permitted to assign certain trust functions to its affiliates. Of course, upon such an assignment, BNY as trustee was liable for any breaches of fiduciary duty committed by its assignees. Similarly, BNY was permitted by the Trust Agreement to use the services of its affiliates in the course of the trust, including to obtain loan funds, and the trustee was permitted to pledge trust assets to secure loans. The loan at issue here was actually made by BNY-Mellon, N.A., a BNY affiliate, and some trust duties were also allegedly carried out by that entity. Because BNY cannot escape its fiduciary duties by assignment to an affiliate, I have not differentiated among BNY and its affiliates in this report, and refer to them all as "BNY."

obtained a loan modification to increase their line of credit to $670,000 on August 12, 2005. The loan was secured by a demand note, callable at any time. Security for the note came from a pledge of the assets of Henry's trust, made by the trustees pursuant to the express power to do so granted in the Trust Agreement. The respondents relied on the income from the trust to make the payments on the loan as well as provide them income. In the economy of the last several years, the trust income proved insufficient for this purpose. In February 2009, BNY called the note, and, through this petition for instructions, seeks repayment of its loan from the assets of Henry's trust.[4] Respondents filed a counter petition, alleging that BNY had breached fiduciary duties imposed on it as trustee. After oral argument in this matter, I granted summary judgment to BNY on the issue of whether, as trustee of Henry's trust, it could authorize release of the assets of the trust to satisfy the demand note. I found that such a release or payment would not, in itself, be a breach of fiduciary duty. I denied the request in the counter-claim that I enjoin the Trust from releasing funds to satisfy the demand note, and found against the respondents' claim that the fees taken by BNY as trustee represented a breach of fiduciary duty. What remains for this written Opinion is whether BNY is entitled to summary judgment on the issue of breach of fiduciary duty in its management of Henry's trust.

[4] Both respondents are under bankruptcy protection.

STANDARD

The path to summary judgment is well-worn. Summary judgment will not be granted unless it appears from the record, examined in the light most favorable to the non-moving party, that no issue of material fact exists and that summary judgment is appropriate as a matter of law.[5]

DISCUSSION

Under Title 12, Section 3303 of the Delaware Code, the responsibilities of the trustees to the settlor/beneficiary are set forth in the Trust Agreement (the "TA").[6] Accordingly, whether the trustees have satisfied or breached their fiduciary duties under the agreement is governed by the language of the TA itself. That document accords broad discretion and power to the trustees (BNY)—it permits them to delegate certain functions to affiliates of BNY, to distribute assets to the beneficiary at their sole discretion, and to pledge assets of the trust as security in procuring additional loans to the respondents from BNY. At common law, a loan from a trustee to a beneficiary, secured by assets held in trust for the beneficiary, would be "virtually prohibited" as an interested

[5] Ch. Ct. Rule 56.

[6] *See* 12 *Del. C.* § 3303 ("It is the policy of this section to give maximum effect to the principle of freedom of disposition and to the enforceability of governing instruments."). Essentially, so long as an instrument does not purport to exculpate or indemnify a fiduciary for *intentional misconduct*, the language of the contract governs. Thus, any rights or responsibilities of the trustee are expressly dictated by the terms of the TA.

transaction.[7] Such a transaction on the part of the trustee would be voidable by the beneficiary, and would constitute a breach of duty unless the terms were entirely fair to the beneficiary.[8] Under the terms of the TA, on the other hand, the settlor/beneficiary specifically provided that self-interested transactions were permitted in the discretion of the trustees, who would not be liable for their exercise of discretion made in good faith.[9] The question then becomes whether the actions of BNY here, in both pledging trust assets to support the loan and in managing the trust in light of the pledge, were taken in good faith.

In arguing that they did, indeed, act in good faith, BNY points first to the language of the pledge agreement itself. That document was entered by the trustees, under the specific authority of the TA. The pledge agreement contains a provision that, in case of a conflict between BNY's duties as fiduciary and rights as lender, "Pledgor expressly agrees that Lender's rights as Lender shall take precedence over Lender's obligations as Fiduciary."[10] While the respondents were aware of, supported and accepted the fruits of

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[7] *See Oberly v. Kirby*, 592 A.2d 445, 466 (Del. 1991) ("Under trust law, self-dealing on the part of a trustee is virtually prohibited."); *Vredenburgh v. Jones*, 349 A.2d 22, 33 (Del. Ch. 1975) ("It is . . . a fundamental principle of our law that one who stands in such a fiduciary capacity shall not act for himself in any matter with respect to which he has duties to perform or interests to protect for another.").

[8] *Oberly v. Kirby*, 592 A.2d at 466 ("An interested transaction is not void but is voidable, and a court will uphold such a transaction against a beneficiary challenge only if the trustee can show that the transaction was fair and that the beneficiaries consented to the transaction after receiving full disclosure of its terms."); *see also Stegemeier v. Magness*, 728 A.2d 557, 563 (Del. 1999); *Vredenburgh*, 349 A.2d at 33. A court of equity can also approve a self-interested transaction if it finds the transaction to be in the best interests of the trust's beneficiaries. *See id*.

[9] *See, e.g.*, Trust Agreement § IV(C) ("I authorize my trustee to . . . [b]orrow from anyone, even if the lender is a trustee hereunder, and pledge property as security for repayment of the funds borrowed."); Trust Agreement § IV (M) ("I authorize my trustee to . . . [p]ledge assets as collateral or as security for any amounts borrowed pursuant to this Article IV."); (Trust Agreement § VI(C) ("Exercise of Discretion: C. Conclusive Upon Al Parties: Any discretion under this document—if exercised or not exercised as long as done so ***in good faith*** shall be conclusive upon all persons concerned. *My trustee shall have no further responsibility over funds paid or applied using this standard of care.*") (emphasis added).

[10] Pledge Agreement 5.

the pledge of assets, the record is in conflict as to whether they were aware of and agreed to the exculpatory clause quoted above, or whether such a provision is commercially reasonable and thus a good-faith exercise of the trustees discretion to pledge. Certainly, if the exculpatory provision were enforceable, the analysis could end here—BNY was expressly authorized to act as it did and put its rights as lender above its fiduciary obligations under the pledge agreement. Nonetheless, because there is a factual dispute as to the validity of the exculpatory provision, for purposes of this motion only I will consider the duties of BNY as though the exculpatory provision of the pledge agreement did not exist. Therefore, I must consider the challenged actions of BNY under the standard of conduct—good faith exercise of discretion—set out in the TA.

In order to conduct such an analysis, I must consider the facts leading to the calling of the note and the demand for redemption of the pledge closely. The demand note entered by respondents contained a margin limit in an effort to protect the collateral on the loan (i.e., the trust). Specifically, the trust corpus—maintained as an investment account pledged to the repayment of the note—was required to "at all times maintain eligible collateral having a margin value which is not less than the outstanding balance" of the loan, and permitted BNY to issue a margin call requiring that the condition be met by increasing eligible collateral or by payment of debt. As market conditions deteriorated in 2008, and as the trustees continued to exercise their discretion to make distributions to Rohlf, the value of the trust corpus decreased and the account approached the margin requirement. As a result of the need to maintain sufficient assets in the face of the decline of securities, and to accommodate the respondents' request for additional

distributions to them, in the fall of 2008 BNY decided, with the specific acquiescence of Rohlf, to convert the trust assets to cash and liquid investments. After this was accomplished, BNY made a final $10,000 distribution to Rohlf, but refused requests for further disbursements. For reasons that are in dispute, the trust did not itself make payments on the interest of the loan, and, according to the respondents, without further distributions they were unable to make payments themselves. A few months after the conversion to liquid assets, in February, 2009, BNY called the loan, and this litigation resulted.

Respondents argue that BNY breached its duty with respect to the conversion of trust assets to cash and the subsequent calling of the note. Respondents acknowledge that they acquiesced in the conversion to cash assets, and accepted a distribution made possible by that conversion. They argue, however, that the trustees' maintenance of the trust in liquid assets after the time of that final distribution was part of a plot to bring about a default of the loan, so that BNY could satisfy the note out of the assets of the trust. Respondents speculate that a potentially higher return from securities would have been sufficient to allow the trust to make the required interest payments out of the income generated by the trust. According to this view, BNY kept the assets liquid in order to reduce the value of the trust to allow a default. The respondents also point to the failure of the trustees to make interest payments from the corpus of the trust during this period, resulting, according to them, in the note being called.

The trustees had a fiduciary duty to make investment decisions in the interest of the beneficiary. According to the TA, they could exercise their discretion to make such

decisions without liability to the beneficiary, so long as they acted in good faith. Respondents point to the chain of events above as evidence of bad faith. But the respondents have failed to allege facts which, if true, would demonstrate bad faith. In essence, respondents' argument is that BNY kept the trust assets liquid, not to satisfy the loan margin requirement and to protect against further erosion of the value of the assets in a declining market, but rather, to intentionally reduce the value of the trust to hasten the call of the note. That argument, however, is unpersuasive. How could a reduction in the value of its own collateral be in the interests of BNY? Why would the trustee plot to force a default in order to authorize a call on the loan which BNY, as lender, was already entitled to make at any time under the explicit terms of the demand note? BNY stood on both sides of this transaction; if it manipulated the trust in a way that was favorable to itself and to the detriment of the beneficiary, it has not acted in good faith, and is liable under the TA for a breach of fiduciary duty. BNY has provided record evidence that it pledged the assets at Rohlf's request, in a good faith effort to facilitate the loan, and that it converted trust assets from securities to cash to comply with the terms of the Demand Note that the respondents had entered, again in good faith. The respondents have simply failed to articulate a theory, and have failed to allege any specific facts, which would indicate that BNY acted in bad faith.[11] Because respondents have failed to allege facts indicating that the trustee/lender's decision to pledge trust assets, and to liquidate and

[11] *Health Solutions Network, LLC v. Grigorov*, 12 A.3d 1154 (Table), at *2 n.13 (Del. 2011) ("Bare assertions or conclusory allegations are insufficient to create a genuine issue of material fact for trial.") (quoting *N. Am. Philips Corp. v. Aetna Cas. & Sur. Co.*, 1995 WL 628444, at *7 (Del. Super. Apr. 20, 1995). In other words, a party opposing summary judgment "must present more than just 'bare assertions, conclusory allegations or suspicions' to show the existence of a genuine issue." *Podobnik v. U.S. Postal Service*, 409 F.3d 584, 594 (3d Cir. 2005) (quoting *Celotex Corp. v. Catrett*, 477 U.S. 317, 325 (1986)).

hold trust assets in cash, were taken in bad faith, summary judgment on the remaining fiduciary duty claims is appropriate.

I am mindful that a trust agreement that specifically contemplates self-dealing on the part of the trustees is an invitation to manipulation of circumstances against the interests of the beneficiaries. The respondents have pointed to no facts indicating such a manipulation took place here. However, rather than entering summary judgment immediately, I will permit the respondents 20 days within which to seek leave to file an amended counter-petition alleging with specificity actions taken in bad faith by the trustee that resulted in a loss to the Trust or its beneficiary.