

Title: Is Delaware Losing Its Luster?

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Delaware has long been the top-of-mind domicile for businesses and trusts. But Delaware's vaunted status as the "go-to" state may be at risk.

Settlers of trusts have favored Delaware for decades, for good reason. They don't need to be residents of the state. Their Delaware trusts can hold personal property forever and real property for 110 years. Delaware imposes no fiduciary tax on irrevocable trusts that accumulate income and capital gains for beneficiaries living outside the state. Delaware trusts are private: they aren't filed with courts and can be drafted so that individual and charitable beneficiaries aren't required to be notified of their present or future interests. And irrevocable Delaware trusts are expected to be beyond the reach of their beneficiaries' future creditors.

But a recent family drama with broad implications suggests that Delaware trusts may not afford beneficiaries the asset protection they might have expected. Glenn Kloiber established a "support trust" for the benefit of his son Dan and Dan's spouse and descendants in 2002. By the time Dan and his wife Beth decided to divorce in 2014, the trust had grown to \$310 million, in large measure because in 2003 Dan sold his company to the trust at a substantial discount and the trust later sold it to an unrelated third party at its full fair market value. To Dan's surprise, Beth, who asserted a claim against the trust as a so-called "exception creditor," walked away from the marriage with a \$29 million mansion and other trust assets, clearly defeating Glenn's original intent.

Kloiber v. Kloiber, which was settled by the parties and never adjudicated in court, doesn't stand for the proposition that Delaware trusts are susceptible to claims of divorcing spouses in a beneficiary's divorce. But it does demonstrate the folly of gifting marital assets to a trust while retaining the benefit of those assets, as Dan did.

Still, the rights of exception creditors in Delaware—divorcing spouses or those seeking alimony or child support—are one reason trust settlers are domiciling or re-domiciling their trusts in Nevada and other, arguably more hospitable states. Nevada law doesn't recognize exception creditors and neither do the laws of Alaska, Illinois, Ohio, South Dakota, Tennessee, and Wyoming. Yet Nevada offers most of the advantages found in Delaware. Nevada allows for self-settled spendthrift trusts; permits trusts to last for 365 years, skipping many generations for estate tax purposes; imposes no state income tax on trust income or gains; allows for trusts to be modified should beneficiaries'

needs or tax laws change, or should trust provisions become outdated; and provides an effective means of quashing challenges to trust provisions.

While some trust settlers and beneficiaries are wondering whether Delaware is the right jurisdiction for them, some businesses are souring on the state as a corporate haven.

No other state has matched Delaware's decidedly pro-management, business-friendly reputation. Managers have enjoyed unfettered discretion to make most decisions. Their companies have been shielded by tough anti-takeover laws. And specialized business courts have backed up corporations asserting novel defenses to the myriad of claims inevitably brought against Big Business.

But things seem to be changing. In a 2015 opinion, Delaware's Court of Chancery found that David H. Murdock, the nonagenarian billionaire CEO of the Dole Company, fraudulently drove down the company's stock price so he could buy the business on the cheap in its 2013 leveraged buyout. To the surprise of many commentators, he and a top lieutenant were found liable for \$148 million in damages.

Dole is one of several companies—DuPont Co. and Abcestry.com Inc., among others—now crying foul. They claim that a growing tide of shareholder lawsuits isn't being stemmed by the state as they believe it should. Michael Carter, Dole's former COO, argues that Delaware is "trending the wrong way" in not protecting the "balanced corporate environment" for which the state's brand has long stood.

As officers and directors of some public companies are evaluating and re-evaluating the decision to call Delaware home, so too are social entrepreneurs.

Unlike Illinois and ten other jurisdictions, Delaware has no law authorizing the organization of Low-profit Limited Liability Companies. Not only may L3Cs attract foundations' program-related investments; they impose charitable or educational priorities on their stakeholders that can't be waived or negotiated away, thereby irrevocably guaranteeing to all of them that mission will always be the venture's paramount objective.

And while Delaware authorizes the organization of Benefit Corporations, mission-driven ventures mandated to pursue a public benefit, its law differs from all the other states' enabling statutes in troubling ways. While Illinois' and 30 other states' laws require Benefit Corporations to produce an Annual Benefit Report which includes an assessment of how well they performed in achieving their social and environmental goals, tested against an independent, third-party standard, Delaware Benefit Corporations need report only every other year, and their reports need not be made available to the public or measured against a third-party standard.

What's more, while all the other states' laws require the directors of Benefit Corporations to consider the interests of stakeholders affected by corporate acts, including shareholders,

employees, the community and the environment, Delaware law imposes on directors of Benefit Corporations only a duty “to consider the interests of those materially affected by the operation of the corporation, in addition to the pecuniary interests of stockholders,” never categorically identifying those non-stockholder stakeholders.

Selecting or maintaining Delaware as a domicile for trusts, traditional businesses and social enterprises isn't a “no-brainer” anymore. If you have any questions about the domicile of your trust or business, please feel free to reach out to me, in confidence. My email address is mlane@MarcJLane.com and my phone number is 312/800-372-1040.



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