IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

W. CHARLES PARADEE, III, as Successor Trustee of the W. Charles Paradee, Sr. Irrevocable Trust Under Agreement Dated December 28, 1989, And As An Individual,	)	
Petitioner,	)	
v.	)	C.A. No. 4988-VCL
ELEANOR CLEMENT PARADEE, as an Individual and as Successor Trustee of the W. Charles Paradee, Sr. Irrevocable Trust Under Agreement Dated December 28, 1989, and WILLIAM J. SMITH, SR. as Successor Trustee of the W. Charles Paradee, Sr. Irrevocable Trust Under Agreement Dated December 28, 1989,	)	
Respondents.	)	

MEMORANDUM OPINION

Submitted: August 6, 2010
Decided: October 5, 2010

Beth B. Miller, MORRIS JAMES LLP, Dover, Delaware; *Attorneys for Petitioner*.

Daniel F. Wolcott, Jr., P. Kristen Bennett, POTTER ANDERSON & CORROON LLP, Wilmington, Delaware; *Attorneys for Respondents.*

LASTER, Vice Chancellor.

This post-trial decision resolves a dispute over the handling of a trust. Judgment is entered in favor of the petitioners and against the respondents.

I. FACTUAL BACKGROUND

The following facts are found after trial. First names are used for clarity and without implying familiarity or intending disrespect.

A. The Paradee Family

William Charles Paradee, Sr. ("Charles Sr."), and his first wife had two children: W. Charles Paradee, Jr. ("Charles Jr."), and Eleanor Lee Cain. Petitioner W. Charles Paradee, III ("Trey"), is the son of Charles Jr. Charles Sr.'s first wife passed away in 1977.

In 1978, Charles Sr. wed respondent Eleanor Clement Paradee ("Eleanor"). Charles Sr. was 71; Eleanor was 54. The marriage strained relationships within the Paradee family, and Charles Jr. reacted vehemently. He resented the relatively rapid remarriage, chafed at the age differential, and bridled at Eleanor's strong personality. Soon after the ceremony, Charles Jr. presented Eleanor with a post-nuptial agreement, which she refused to sign. Their relationship fractured, bitterness ensued, and they came to dislike each other intensely.

The conflict between Charles Jr. and Eleanor spread to Paradee Oil Company, the then-prospering family business. Ultimately, father and son parted ways. In 1985, they split off a relatively small portion of the operations for Charles Jr. to run as a separate company, called Paradee Gas Company.

Both men felt ill-used. Charles Jr. believed Eleanor turned his father against him, and he felt slighted by the small portion of the company he received. Charles Sr. believed his son had betrayed him, and he felt Charles Jr. received far more than he deserved.

B. Charles Sr. Creates The Trust.

Although Charles Sr. and Charles Jr. were estranged, Charles Sr. and Trey maintained a close and loving relationship. For example, in a heartfelt note written in November 1988, Charles Sr. expressed his love for his grandson, his pride in watching him grow up, and described him as "the one to keep the family tree going."

In December 1989, Charles Sr. created the W. Charles Paradee, Sr. Irrevocable Trust Under Agreement Dated December 28, 1989 (the "Trust"). Eugene N. Sterling, a life insurance agent, was appointed initial trustee of the Trust. Sterling generated significant business from Paradee Oil Company. He handled the company's retirement plan, brokered its health insurance plan, and sold life insurance to numerous employees. Charles Sr. and Eleanor were longtime clients.

The Trust was structured to take advantage of an exemption from the generation-skipping tax rules, known as the "Gallo exemption," that expired at the end of 1989. The Trust was funded with contributions in the amount of $183,019 from Charles Sr. and $183,000 from Eleanor. Sterling used the funds to purchase a second-to-die insurance policy on the lives of Charles Sr. and Eleanor from Manufacturers Life Insurance Company (the "Policy"). The Policy was issued on February 15, 1990.

The total initial premium for the Policy was $366,018.47. If the Policy performed as expected, no additional premiums would be required. Due to the single-premium structure of the policy, the death benefit in the first year was $1,744,367. After that, the death benefit was projected to remain at $1,150,700 until 2010, the last date provided in the original illustrations. The undisputed intent of the Trust was to provide insurance proceeds to Trey.

To achieve the death benefit it was designed to deliver, the Policy combined a whole life feature and a term life feature. The initial single premium was used to purchase $191,784 in whole life and $593,666 in paid-up additional insurance. Over the projected life of the Policy, these balances would generate internal policy dividends that would be used to further build up the value of the paid-up additional insurance and to pay each year for an amount of term life insurance sufficient to deliver a total death benefit of $1,150,700. As Charles Sr. and Eleanor aged, the cost of the term life insurance would rise. By building up the policy values internally, less term life insurance would be needed in later years, and the Policy would generate sufficient dividends to support it.

Trey was born on July 18, 1969. At the time the Trust was formed, Trey was nine years old. No one told him about the Trust or the Policy. Under Article 1 of the Trust, Trey had the power to remove the existing Trustee and appoint himself as Trustee once he turned thirty. But 1999 would come and go without Trey ever learning about the Trust's existence. Trey eventually was notified about the Trust in 2009, when he was forty years old.

C. Eleanor Tries to Revoke The Irrevocable Trust.

Three years after creating the Trust, by letter dated July 30, 1993, the Paradees instructed Sterling to revoke it. Although the letter was signed by both Charles Sr. and Eleanor, I find that Eleanor was the driving force behind it. The evidence at trial indicated that Eleanor's influence over the family finances steadily increased during the 1980s, as did her influence over Paradee Oil Company. In 1991, Charles Sr. almost died of heart failure and required quadruple bypass surgery. Although he recovered, he began to slip mentally. I believe Eleanor generally had their financial affairs firmly in hand from that point on. At a minimum, by mid-1993, she was making decisions with respect to the Trust, and the instruction to revoke the Trust in 1993 foreshadowed her repeated efforts to terminate the Trust over the next fifteen years.

The July 30, 1993, letter stated:

> Due to unforeseen circumstances, we wish to terminate the above numbered policy for its cash value.
>
> You will recall that this policy is owned by the W. Charles and Eleanor C. Paradee, Irrevocable Trust.
>
> Please advise what steps are to be taken to expedite the surrender of this policy, and to revoke the above mentioned Irrevocable Trust and return the cash value to the undersigned.

JX 51. Upon receiving the letter, Sterling sent a copy to Joanna Reiver, Esq., the attorney who drafted the Trust. Reiver had represented the Paradees since the late 1970s.

Reiver spoke with Eleanor, who said the cash was wanted because of unexpected back taxes on diesel fuel sales by Paradee Oil Company. Eleanor put the total bill at approximately $200,000. A contemporaneous court filing put it at $155,000. Eleanor told Reiver that the Paradees did not want to pay the tax out of their personal funds because it would "ruin their 'balance' in terms of income and principal." Sterling was given the same explanation.

At the time, the Paradees owned significant assets, enjoyed ample income, and had minimal (if any) debt. In 1988, the Paradees sold the operating assets of Paradee Oil Company for approximately two million dollars. They changed the name of Paradee Oil Company to Silver Corporation, and that entity continued to own the land where the company's service stations were located. Through Silver Corporation, the Paradees leased the land to the acquirers of the business for approximately $180,000 per year. The Paradees also owned approximately a dozen commercial properties in the Dover area, including Moore's Lake Shopping Center and 20-plus acres on Route 13 near the Dover Mall. The properties were unencumbered.

Given her significant wealth and her pattern over the ensuing decade and a half of repeatedly attempting to terminate the Policy and extract its value, I do not credit Eleanor's proffered justification about preserving the "balance" of the Paradees' investments. Eleanor simply preferred for selfish reasons to shift the cost of their tax bill to someone else. Although there is no such thing as a free lunch, it is always nicer (all else equal) if someone else pays. Eleanor wanted someone else to pay.

For Eleanor, having that someone else be the Trust was doubly sweet. She despised Charles Jr., and I suspect she had no particular love for his son. Although it would be several years before her animosity towards Trey flowered in its own right, the seeds already were planted. Revoking Trey's Trust to pay the diesel tax would force

Charles Jr.'s family to foot the bill. To attribute this unkind motive to Eleanor might seem harsh, but the evidence supports it, and it is sadly consistent with the vindictive and vengeful behavior that Eleanor displayed on other occasions.

D. Silver Corporation Borrows From The Trust.

Having been notified by Sterling about the Paradees' request, Reiver consulted with Eleanor about alternatives. In substance, Reiver told Eleanor that "irrevocable" meant "irrevocable," and that the Paradees could not access the Policy's cash value by revoking the Trust. Reiver and Eleanor then talked about whether the Trust nevertheless could loan money to the Paradees. Reiver discussed the idea with Sterling.

By letter dated September 2, 1993, Sterling responded:

> Following find a quotation of the values of the Joint Life Insurance policy insuring the Paradees.
>
> I can find no reason not to loan out a portion of the [Policy] value. The loan will be deducted at death, therefore the grandson will receive less than the full value of the Joint Life Death Benefit.
>
> Assuming that the loan interest is 8% per year, a loan of $200,000 would require an interest payment of $16,000 per year. Assuming a $3,000 per year increase in the $104,065 remainder should pay the interest for 8 years plus [sic]. I want to point out that the interest, if unpaid, could cause the policy to lapse.

JX 30.

Sterling retained Mark Olson, Esq. to advise him about the loan. In a letter dated October 13, 1993, Olson wrote that "Subparagraph 11 of paragraph A of Article 11 authorizes the trustee to make loans with adequate security and at a reasonable rate of interest." JX 8. He continued:

> I suggest the following. Any loan to be made by the trust to Mr. or Mrs. Paradee should be made upon terms comparable to those which a commercial bank would offer. This would mean that the loan would be made at prevailing interest rates and would most likely require monthly amortization. In addition, security would be required in an amount at least equal to 125% of the loan (to yield an 80% loan to value ratio). The easiest way to establish this, of course, would be to require the proposed borrower to obtain a loan commitment from a commercial bank. In no case should the trustee make a loan unless the loan payments will be adequate to cover debt service on the policy loan plus the amount required to keep premiums current.

Id.

With Olson's advice in hand, Sterling obtained a $150,000 loan on the Policy from Manufacturers Life Insurance Company (the "Policy Loan") to fund the Trust's loan to the Paradees (the "Trust Loan"). The Policy Loan charged compound interest at a floating rate set in the first year at 8.75%, subject to change on an annual basis.

Sterling asked Reiver to document the Trust Loan. Reiver had one of her law partners take care of it. The resulting promissory note was dated November 18, 1993, and executed by Charles Sr. on behalf of Silver Corporation. Sterling wrote a check dated November 18, 1993, on the Trust's account for $150,000, payable to Charles Sr. and Eleanor.

Contrary to Olson's advice about obtaining security equal to 125% of the loan amount, the Trust Loan was unsecured. Contrary to the Policy Loan's floating rate, the Trust Loan's interest rate was fixed. Contrary to the compound interest charged by the Policy Loan, the Trust Loan did not specify whether interest would be simple or compound. The respondents maintain it was simple interest. The Policy Loan charged 8.75% interest in the first year. The Trust Loan charged 8%.

Although the Trust Loan called for interest to be paid monthly, Sterling made no effort to collect it. Sterling instead established a practice of writing to the Paradees annually and requesting that interest for the year be paid in February. Interest was paid in due course in 1994, 1995, 1996, and 1997.

E. Eleanor Tries Twice More To Revoke The Trust.

Despite having obtained the $150,000 loan, just one year later Eleanor again instructed Sterling to revoke the Trust and pay out the cash value of the Policy to the Paradees. Eleanor proffered the same justification about diesel taxes as she had the year before. Sterling reminded Eleanor that the Trust was irrevocable. He also admitted that the prior year's loan "was really stretching it." JX 118.

On December 12, 1997, Reiver received a telephone call from the Paradees' accountant, Jordan Rosen. Rosen told Reiver that the Paradees wanted to collapse the Policy, take the cash, repay the Note, and invest the balance of the cash for Trey's ultimate benefit. Again, I find that Eleanor was behind the ostensibly joint request, and the evidence shows that at this point, Charles Sr. was failing rapidly. Eleanor called Sterling herself to ask that the Policy be terminated.

In February 1998, Eleanor told Sterling that the Paradees could not pay the interest on the Trust Loan. She said they wanted the Policy surrendered for its then-cash value of $155,000 and the proceeds used to make a different investment. Sterling wrote to Olson:

“I need guidance on what to do. Can I comply with the wishes of the Senior Paradee’s [sic] without jeopardizing my position?” JX 52.

Olson responded with a letter addressed to Sterling but facially intended to be sent to the Paradees (among other things, it referred to Sterling in the third person). At bottom, Olson advised that Sterling risked personal liability if he agreed to Eleanor’s latest request:

> The trust owned a paid-up policy with a $1.1 million death benefit. If the proceeds of any smaller policy plus the loan to the Paradees (assuming it to be collectible) do not aggregate $1.1 million [sic], the trust beneficiary (W. Charles Paradee, III) could bring an action seeking to hold you personally responsible for the difference.
>
> These are obviously very serious problems in which Gene Sterling seems to be stuck in the middle. I advise you strongly <u>against</u> surrendering the existing policy.

JX 53. Sterling forwarded Olson’s letter to the Paradees, who then paid the interest.

On July 1, 1998, Charles Sr. passed away. Under the terms of the Trust Loan, the Trust had the right to recover the principal and interest due at any time after the earlier of the death of Charles Sr. or Eleanor. Sterling made no effort to collect.

On July 18, 1999, Trey turned 30. Article 1 Section C of the Trust provided that “after my [Charles Sr.’s] death, and upon reaching age 30, my grandson, W. Charles Paradee III, shall be entitled to serve as trustee hereunder . . . .” Sterling did not notify Trey.

F. The Demutualization Of Manufacturers Life Insurance Company

On September 24, 1999, Manufacturers Life Insurance Company demutualized and became Manulife Financial Corporation ("Manulife"). Eligible policyholders, including the Trust, were entitled to receive either cash or Manulife shares.

As a result of the demutualization, the Trust received 6,261 shares of Manulife stock. Because the Policy Loan reduced the cash value of the policy on which the share calculation was based, the Trust received fewer shares than it otherwise would have. Manulife stock later split two-for-one, doubling the number of shares held by the Trust.

G. The Anagnos Incident

In September 2000, Charles Jr. sold Paradee Gas Company. After the sale, Trey went to work for Merrill Lynch. He became a licensed stock broker in July 2001.

An incident that summer caused Eleanor's antipathy towards Trey to erupt into open hostility. On at least three occasions, Eleanor invited Trey to have lunch with her stock broker, John Anagnos. Eleanor thought Anagnos was a highly experienced broker from New York City who only handled high net-worth clients. With Trey having recently entered the profession, Eleanor wanted him to see a successful broker first-hand.

During one lunch, Eleanor praised Anagnos' acumen in selling her a bond that paid a guaranteed return of 14%. Trey was stunned. It was the summer after the dot-com crash. The Federal Reserve was steadily cutting interest rates, and certificates of deposit were paying perhaps five percent.

After Anagnos left, Trey asked about the bond. Eleanor reiterated that it paid a guaranteed 14%. Feeling something was not right, Trey asked for the prospectus, which

Eleanor gave him. It described a speculative investment in an unregistered real estate partnership. The return was not guaranteed, but Eleanor's $100,000 investment had guaranteed (in the colloquial sense) an up-front commission of 10% for Anagnos.

His concern heightened, Trey asked to see Eleanor's brokerage statements. Eleanor took him into the dining room, where papers were stacked in piles. With Eleanor's permission, Trey looked through the documents. He immediately spotted several red flags. Most notably, a summary statement that Anagnos provided was not an automatically prepared, standardized statement. It was a homemade document that Anagnos seemed to have typed up on a word processor. It tracked the total assets in Eleanor's accounts without differentiating between contributions and investment returns. It then compared the percentage growth in the account to purported returns on the "S&P."

Trey asked Eleanor if he could have a copy of the statement. She made him a copy on the copier she kept in her basement. Trey took the statement and did some research. He discovered that while the statement listed the "S&P" as down 8.64%, during the period identified the S&P 500 actually rose nearly 11%. He concluded that in any event, the S&P 500 was a misleading comparable for Eleanor's mix of investments. He also discovered that Anagnos became a broker shortly before Trey and worked out of an office in Wilmington.

Having done his homework, Trey returned to Eleanor's house and conveyed his concerns. He testified credibly at trial that he was not trying to get access to Eleanor's money; he feared Anagnos was taking advantage of her. Trey also recalled promising his grandfather that he would look out for Eleanor after Charles Sr. died.

Eleanor reacted angrily. She accused Trey of stealing her documents and meddling in her affairs. She told Trey to leave, which he did. Some time later, Trey returned to Eleanor's house in the hope of having a more measured conversation. Eleanor again became distressed.

Trey's subsequent attempts were no more successful. Some months later, still concerned about Eleanor, Trey wrote to Anagnos' supervisor and laid out his findings. He asked the supervisor to "look into these matters and take whatever steps you deem necessary." Trey gave a copy of the letter to Eleanor.

After this incident, Eleanor wanted nothing to do with Trey. She was short and curt whenever he called or stopped by, and she made it clear that he was not welcome in her home. In 2003, Trey and Eleanor separately attended a fundraiser at Wild Quail Country Club. Eleanor spent the evening telling her table that Trey was trying to take her money and had hired a team of doctors and lawyers to help him. It was a delusional notion, but Eleanor believed it. Eleanor's lawyer, Reiver, testified that after the Anagnos affair, Eleanor was "distressed" and "very, very concerned" that Trey was trying to gain control over her and her assets. Eleanor's accountant testified that Eleanor "felt very threatened." William J. Smith, Eleanor's longtime handyman and recently adopted son (for estate planning purposes), testified that Eleanor was "very upset" and "thought she had been violated."

H. Eleanor Appoints Herself Trustee.

During early 2003, Eleanor asked Reiver to contact Sterling. According to Reiver's notes, Eleanor wanted Reiver to find out the current face value of the Policy, whether it was paid up, and whether there was "[a]nything we can do about it." In an email to her paralegal, Reiver mentioned the existence of the Trust Loan and stated, "I think we can safely assume that if Eleanor, individually, was the borrower, she has no intention of paying it off during her lifetime." Reiver spoke with Sterling and asked him, "Is there any way the policy can lapse?" Sterling responded, "Don't pay the interest."

On April 2, 2003, in the midst of the furor over Anagnos, Sterling died. Reiver reviewed the Trust to determine who would become the successor Trustee. She noted that Trey could serve as his own Trustee once he was 30 years old, and she advised Eleanor of that fact. Although Reiver could not recall precisely when she gave that advice, Reiver is a careful and experienced attorney, and I find that she did so when advising Eleanor following Sterling's death and again in 2005 when Eleanor appointed Smith as successor Trustee.

On or before April 21, 2003, Eleanor again asked her advisers to look into how she could access the remaining Trust funds, such as through a further loan from the Trust. On April 23, 2003, Eleanor appointed herself Trustee. It is undisputed that Eleanor knew Trey was over 30 at the time. He had turned 30 in 1999, four years earlier.

I. The Policy Fails.

In 2003, for the first time, Silver Corporation failed to pay the interest due on the Trust Loan. No further payments were made. As a result, on February 15, 2003, \$11,026.84 of unpaid interest was capitalized and added to the outstanding Policy Loan balance. On February 15, 2004, \$11,732.74 of unpaid interest was capitalized and added to the outstanding Policy Loan balance. On February 15, 2005, \$10,847.73 of unpaid interest was capitalized and added to the outstanding Policy Loan balance. On March 15, 2005, an additional $792.60 of unpaid interest was capitalized and added to the outstanding loan balance. With a total outstanding loan balance of $185,203.94, the Policy lapsed.

At the time the Policy lapsed, the Trust owned 6,261 shares of Manulife stock with an approximate value of $300,027.12, and it held approximately $20,000 in a savings account, representing the dividends paid on the Manulife shares and interest received on those amounts. The Policy also held the promissory note from Silver Corporation, which owed the Trust $150,000 in principal and a minimum of $22,759.58 in simple interest. Those amounts were due and payable on demand.

During this time, Silver Corporation was owned by the W. Charles Paradee Charitable Remainder Annuity Trust. Eleanor was the trustee of the Charitable Remainder Annuity Trust and its sole income beneficiary. She was the only person with check-writing authority for the Charitable Remainder Annuity Trust.

During her years as Trustee, Reiver advised Eleanor that she had a duty to notify Trey about the Trust, was obligated under the Trust to pay income to Trey, and should use Trust assets to maintain the Policy. Eleanor declined to follow Reiver's advice and did none of these things. Eleanor instead discussed with Reiver and Rosen how to collapse the Policy and access its cash value.

Reiver testified to Eleanor's motive in allowing the Policy to lapse: "I think that she did not want [Trey] to be in a position where he would be better off on her death, and know about it, and be in control of it." I agree. Eleanor consciously, intentionally, and vengefully refused to take any action to protect or preserve the Policy because she did not want Trey to benefit.

J. Smith Becomes Trustee.

On July 7, 2005, after the Policy lapsed, Eleanor resigned and appointed Smith as the Trustee. Smith began working for Charles Sr. in the early 1960s as a handyman. He performed general contracting and masonry work. After Charles Sr. remarried, Smith began doing odd jobs for Eleanor around the house. His role evolved into providing general domestic help to the Paradees. He drove them to and from Florida, assisted Eleanor in caring for Charles Sr. when he was ill, and helped Eleanor around the house after Charles Sr. died. On June 8, 2004, for estate planning reasons, Eleanor adopted Smith.

After becoming Trustee, Smith initially followed Eleanor's lead and did not inform Trey about the Trust's existence, that he was the sole beneficiary of the Trust, or that he had the right to act as his own Trustee. Smith also continued Eleanor's practice of not distributing the Trust's income to Trey.

Unlike Eleanor, who acted knowingly and purposefully as Trustee with the intent to benefit herself and harm Trey, Smith testified credibly that he did not understand his obligations to Trey and regarded the Trust as just another one of Eleanor's accounts. Smith is not financially or legally sophisticated. He is a straightforward and honest workingman whose character would be captured in a rural area like Virginia's Shenandoah Valley by the grammatically challenged phrase, "he's good people." Although Smith certainly is loyal to Eleanor, he exhibits the commendable fealty of a longtime employee who recognized both the virtues and the shortcomings of his employer. I do not believe he acted with avarice, ill-will, or as a co-conspirator in Eleanor's campaign to harm Trey.

In 2007, Smith came to understand Trey's interest in the Trust. He told Reiver that he wanted "to do what is right," and he asked for a letter instructing him on what to do. It took Reiver another *two years* to notify Trey. No one could explain why it took so long. Even recognizing that Reiver sought information from various sources and moved offices twice during that period, her efforts were disappointingly intermittent and tortoise-like. I suspect she knew litigation would result and was not in a hurry to set it in motion.

K. Trey Becomes Trustee.

On August 18, 2009, Trey received a letter from Reiver informing him about the Trust. Trey promptly exercised his right to become Trustee and demanded that the Trust Loan be paid. On September 30, 2009, Silver Corporation paid the Trust $340,389.04, comprising $150,000 in principal and $190,398.04 in interest.

II. LEGAL ANALYSIS

"A violation by a trustee of a duty the trustee owes to a beneficiary is a breach of trust." 12 *Del. C.* § 3581(a). "To remedy a breach of trust that has occurred or may occur, the court may order any equitable remedy . . . ." 12 *Del. C.* § 3581(b). The remedy may include "[c]ompelling the trustee to redress a breach of trust by paying money, restoring property, or other means." 12 *Del. C.* § 3581(b)(3). "A beneficiary may charge a trustee who commits a breach of trust with . . . [t]he amount required to restore the value of the trust property and trust distributions to what they would have been had the breach not occurred . . . ." 12 *Del. C.* § 3582. Eleanor and Smith breached their trust, and the petitioners are entitled to a remedy.

A. The Decision To Make The Trust Loan

The petitioners proved at trial that Eleanor aided and abetted Sterling in breaching his fiduciary duties by making the Trust Loan. To prevail on a claim for aiding and abetting a breach of fiduciary duty, the petitioners had to prove (1) the existence of a fiduciary relationship; (2) that the fiduciary breached his duty; (3) that the non-fiduciary defendant knowingly participated in the breach; and (4) damages resulting from the concerted action of the fiduciary and the non-fiduciary. *Jackson Nat'l Life Ins. Co. v. Kennedy*, 741 A.2d 377, 386 (Del. Ch. 1999).

1. Sterling Breached His Fiduciary Duties.

At the time he made the Trust Loan, Sterling was Trustee and a fiduciary for the Trust. As Trustee, he was "under a duty to [the] trust beneficiary to administer trust property solely in the interests of the beneficiary." *Walls v. Peck*, 1979 WL 26236, at *4 (Del. Ch. Oct. 24, 1979). As a part of the duty of loyalty, a trustee "must exclude all selfish interest and all consideration of the interests of third persons." George Gleason Bogert & George Taylor Bogert, *The Law Of Trusts And Trustees* § 543 (2d ed. 1993). Sterling also had a duty to manage the Trust "with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use to attain the purposes of the account." 12 *Del. C.* § 3302(a); *see DuPont v. Delaware Trust Co.*, 320 A.2d 694, 697 (Del. 1974) ("Not only must the trustee deal with trust property with ordinary prudence but he is held to two additional standards: (1) since he is dealing with the property of another for whom he is morally bound to provide, he must avoid even those risks which he might take with his own property and (2) he must take no risk which endangers the integrity of the trust corpus.").

When deciding whether the Trust should loan money to the Paradees, Sterling breached his duty of loyalty. Instead of evaluating what was in the best interests of the Trust, he evaluated whether he could please his long-time clients, the Paradees. Sterling should have asked himself whether the Trust Loan was good for the Trust. He chose instead to ask whether there was a plausible reason to think the Trust Loan could be extended without harming the Trust. As Sterling stated in his letter to Reiver, "I can find no reason not to loan out a portion of the [Policy] value." JX 30. He should have examined the Trust Loan from precisely the opposite point of view: whether there was any reason *to* loan a portion of the Policy value. Sterling revealed a similar mindset in 1998, when he asked Olson, "Can I comply with the wishes of the Senior Paradee's [sic] without jeopardizing my position?" JX 52. Rather than trying to comply with the "wishes of the Senior Paradee's [sic]," he should have been acting in the best interests of the Trust.

If Sterling had considered what was best for the Trust, he would have refused the Paradees' request. At the time, the Trust owned a fully paid, single-premium second-to-die insurance policy that would pay a seven-figure benefit. There was no upside to the Trust in loaning funds to an entity controlled by the Paradees, and much less so on an unsecured basis and at a fixed rate approximating (but initially less than) the floating interest rate on the Policy Loan. The Trust Loan imposed default risk and interest rate risk on the Trust for zero compensation. The Trust Loan might have looked marginally better if Sterling had negotiated for a premium rate and security. But, even then, Sterling possessed a paid-up asset sufficient to fulfill the purpose of the Trust: providing insurance proceeds to Trey. Under the circumstances, Sterling's fiduciary duties required that he preserve the Policy. Instead, Sterling swapped cash for an unsecured, contingent promise to pay made by an entity controlled by individuals who asked initially whether they could "revoke the 'Irrevocable Trust'" and only fell back on the Trust Loan when told they could not take the cash directly.

In attempting to defend Sterling's decision, the respondents cite Article 11, subparagraph 11A of the Trust. That provision authorized Sterling to make loans from the Trust with adequate security and at a reasonable rate of interest. Sterling's power to make the Trust Loan does not answer the separate question of whether he breached his fiduciary duties by doing so. *See Sample v. Morgan*, 914 A.2d 647, 672 (Del. Ch. 2007) (explaining that exercises of authority by fiduciaries under Delaware law are "'twice-tested'–once by the law and again by equity"). *See generally Schnell v. Chris-Craft Indus., Inc.*, 285 A.2d 437, 439 (Del. 1971) ("[I]nequitable action does not become permissible simply because it is legally possible.").

The respondents also claim Sterling relied on advice of counsel in the form of the letter he received from Olson. The letter addressed only the Sterling's authority to make the Trust Loan. Olson also identified some fiduciary concerns, but he did not opine as to

Sterling's compliance with his fiduciary duties. Olson's letter on its face expresses no such opinion, and attorneys customarily do not opine on fiduciary duty issues.[1]

Under the circumstances, Olson's letter cannot operate as a defense to Sterling's breach of his duty of loyalty. Obtaining advice of counsel provides some evidence that a fiduciary is not acting disloyally, but it is not dispositive.[2] By statute, Delaware authorizes trustees to be exculpated from liability when following the direction of an advisor. 12 *Del. C.* § 3313(b). The statute does not eliminate the underlying breach, and exculpation is not available "in cases of willful misconduct." *Id.*; *cf.* Restatement (Third)

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[1] *E.g.*, The Opinions Committee of the Business Law Section of the State Bar of California, *Report on Selected Legal Opinion Issues in Venture Capital Financing Transactions*, 65 Bus. Law. 161, 189-90 (2009) ("Because compliance with fiduciary duties is not a matter lawyers can reasonably be expected to address, the Committee believes that it is not appropriate for investors to request an opinion that the directors, officers, or majority share-holders have complied with their fiduciary duties."); Committee on Legal Opinions and the TriBar Opinion Committee, *Third-Party "Closing" Opinions*, 53 Bus. Law. 591, 662 n.166 (1998) (closing opinions are "understood as a matter of customary practice not to cover compliance with fiduciary duty requirements even when those requirements are statutory in nature"); Scott FitzGibbon & Donald W. Glazer, *Preparing and Interpreting Opinions in Financial Transactions: Nine Hard Questions*, 583 PLI/Corp 293, 340-41 (1987) (stating that "compliance with fiduciary obligations" is assumed as a premise of legal opinions and thus "ordinarily need not be spelled out").

[2] *See Valeant Pharm. Intern. v. Jerney*, 921 A.2d 732, 750-51 (Del. Ch. 2007) (treating advice of counsel as a factor to be considered when evaluating whether breach of duty occurred, but rejecting 8 *Del. C.* § 141(e) as dispositive defense in duty of loyalty case); *Boyer v. Wilm. Materials, Inc.*, 754 A.2d 881, 910-11 (Del. Ch. 1999) (same); *see also In re Heizer Corp.*, 1988 WL 58272, at *22 (Del. Ch. June 6, 1988) (considering advice of counsel as factor in determining whether to remove trustee for breaches of duty). *See generally In re Borden's Trust*, 56 A.2d 108, 110-11 (Pa. 1948) ("Acting upon advice of counsel is a factor to be considered in determining good faith, but is not a blanket of immunity in all circumstances.").

of Trusts § 77 cmt. b(2) (2007) ("Taking the advice of legal counsel . . . evidences prudence on the part of the trustee. Reliance on advice of counsel, however, is not a complete defense to an alleged breach of trust, because that would reward a trustee who shopped for legal advice that would support the trustee's desired course of conduct or who otherwise acted unreasonably in procuring or following legal advice."). Equally important, subjective good faith standing alone is not a defense: "In this subchapter, 'good faith' means honesty in fact *and the observance of reasonable standards of fair dealing*." 12 *Del. C.* § 3580 (emphasis added). Regardless of whether Sterling subjectively believed he was acting properly because of Olson's letter (and leaving aside that he subjectively wanted to serve the interests of the Paradees), his conduct in approving the Trust Loan fell short of reasonable standards of fair dealing.

In any event, Sterling failed to follow Olson's advice in a material respect. Olson advised Sterling that any loan should be secured by property at least equal to 125% of the loan. Sterling made an unsecured loan. *Cf.* 12 *Del. C.* § 3313(b) (authorizing governing instrument to provide for exculpation if "a fiduciary is to follow the direction of an adviser, *and the fiduciary acts in accordance with such a direction*" (emphasis added)). Advice of counsel therefore cannot provide a defense.

2. Eleanor Knowingly Participated In The Breach.

Eleanor knowingly participated in Sterling's breach of his duty of loyalty. "[I]t is bedrock law that the conduct of one who knowingly joins with a fiduciary . . . in breaching a fiduciary obligation, is equally culpable." *Mills Acq. Co. v. Macmillan, Inc.*, 559 A.2d 1261, 1284 n.33 (Del. 1989); *see also Laventhol, Krekstein, Horwath &*

Horwath v. Tuckman, 372 A.2d 168, 170-71 (Del. 1976) ("[P]ersons who knowingly join a fiduciary in an enterprise which constitutes a breach of his fiduciary duty of trust are jointly and severally liable for any injury which results.").

Eleanor induced Sterling to breach his fiduciary duties by taking advantage of his primary loyalty to the Paradees. When Eleanor set out to revoke the Trust and access the cash value of the Policy, she sought to have Sterling commit a facially disloyal act.

When told that the "Irrevocable Trust" in fact was irrevocable, Eleanor sought to accomplish the same end through different means. Eleanor had a singular goal: causing Sterling to access the Trust's cash for the Paradees' personal benefit. Reiver and Sterling worked together to provide Eleanor with a technically legal means to achieve that goal: the Trust Loan. However it was achieved, Eleanor's goal was to cause Sterling to breach his duty of loyalty to the Trust by favoring the Paradees.

The collective efforts undertaken in this case to effectuate the Trust Loan differ in kind from the paradigmatic allegations of "knowing participation" that attack a contractual bargain between fiduciaries and a third party. *See generally Morgan v. Cash*, 2010 WL 2803746, at *4-8 (Del. Ch. July 16, 2010) (summarizing and applying "knowing participation" element in third party acquisition). This case did not involve arms' length negotiations, and there was no third party. Eleanor, Reiver, and Sterling together identified and pursued the Trust Loan as the vehicle for achieving Eleanor's improper goal of having Sterling access Trust funds for the Paradees' benefit. Eleanor therefore aided and abetted Sterling's breach of fiduciary duty. She is liable to the same extent as Sterling would have been, had he not passed away in 2003.

B. Other Breaches Of Trust By Eleanor

The respondents do not dispute that once she became Trustee after Sterling's death, Eleanor should have informed Trey about the Trust, should have paid Trey the net income from the Trust, and should have used Trust assets to maintain the Policy. The respondents argue only that the remedy for these breaches of duty should be limited because the Policy Loan was approved ten years earlier. Each of these failures constituted an additional breach of the duty of loyalty by Eleanor.

C. Smith's Breaches of Trust

Smith is differently situated than Eleanor. By the time he became Trustee, the Policy had lapsed. Under the terms of the Trust, Smith was not required to examine the acts of his predecessor and was responsible only for property actually delivered to him as Trustee. There is no evidence that Smith took any actions during his tenure that harmed the Trust. Smith testified credibly about his initial lack of knowledge about the Trust and Trey's rights.

Nevertheless, Smith breached his obligations as Trustee by failing to notify Trey about the Trust, by not making distributions of Trust income to Trey, and by not managing the Trust corpus and instead treating it as simply another of Eleanor's accounts. Although Smith's advisors bear primary responsibility for his failings, a limited remedy against Smith is warranted.

D. The Trust's Remedy

If Sterling had not breached his fiduciary duty by agreeing to the Policy Loan, aided and abetted by Eleanor, then in lieu of what it holds today, the Trust would (i) own the Policy and (ii) have received additional shares of Manulife stock in 1999. If Eleanor and Smith had not breached their obligations by failing to notify Trey of his right to become Trustee, then the Trust could have sold the shares of Manulife during the intervening years for proceeds well in excess of their current value.

For the loss of the Policy, I award damages of $1,150,700 (the "Policy Value"). This figure represents the death benefit that the Policy was designed to achieve under the most likely range of future states of the world at the time the Policy was purchased.

Each side argues for a different figure in recognition of the reality that Eleanor is still alive. I reject as speculative and insufficiently reliable the calculations presented by Trey's expert that project forward future values of the Policy at various anticipated dates of death and then discount those figures back at overly low discount rates. At the same time, I reject as inequitable the respondents' contention that any award of damages should be withheld until Eleanor's actual death. Any deferral of the award would necessitate crafting a mechanism to provide incremental returns comparable to what the Trust would receive under the Policy. I also harbor concern that the respondents would circumvent a contingent remedy through additional estate planning. The Trust is therefore entitled to damages of $1,150,700 for the loss of the Policy Value. Eleanor alone is liable for this element of the award.

But for Eleanor's breaches of trust, the Trust also would have received a greater number of shares of Manulife stock in 1999 and would have had the opportunity to sell those shares at values exceeding where the shares trade today. Trey's expert testified credibly that without the Policy Loan, the Trust would have received a total of 8,169 shares of ManuLife stock in the 1999 demutualization. Those shares would have remained in the Trust as principal, rather than constituting income to be distributed to Trey. *See* 12 *Del. C.* §§ 6106(a), (b)(2). Accounting for a 2:1 stock split that occurred on June 5, 2006, the Trust should have received the equivalent of 16,338 shares. Eleanor alone is liable for losses relating to the incremental shares.

By failing to notify Trey about the existence of the Trust and his right to become Trustee, and by refusing to take actions that would have been in the best interests of the Trust, Eleanor and Smith wrongfully deprived Trey and the Trust of the ability to sell the Manulife shares at values well in excess of where the shares trade today. Where a party has wrongfully deprived another of the ability to sell shares, damages are measured using the highest intermediate value of the shares less the value at the time of judgment. *See Duncan v. Theratyx, Inc.*, 775 A.2d 1019, 1023 (Del. 2000). The highest intermediate value for Manulife's stock was achieved on October 31, 2007, when the stock closed, post-split, at $46.39. Although it would be improbable (bordering on impossible) for the Trust to have sold precisely at the top of the market, the faithless fiduciary must bear that risk, not the innocent beneficiary. *See id.* at 1023.

The Trust is entitled to additional damages of $599,766.96, representing 16,338 shares valued at $46.39 per share, less the 12,522 shares of Manulife stock actually received by the Trust valued at $12.63, which was the closing market price on September 30, 2010. Eleanor and Smith are jointly and severally liable for $422,742.72, representing the amount attributable to the 12,522 shares. Eleanor is solely liable for the incremental $177,024.24, representing the amount attributable to the incremental shares.

Pre-judgment interest is due on the total amount at the legal rate, compounded quarterly, with the rate fluctuating with changes in the underlying Federal Discount Rate. Pre-judgment interest shall run from October 31, 2007, through September 30, 2010. Liability for interest shall parallel liability for the underlying amounts.

The award to the Trust must recognize that the Trust holds assets today that it would not hold if the Trust Loan was never made and the Policy remained in force. The value of these assets must be deducted from the Trust's aggregate award. The assets consist of (i) the cash currently held by the Trust as a result of dividends received over the years on the Manulife stock, (ii) the $340,389.04 paid to the Trust in September 30, 2009, and (iii) any interest the Trust has received on those amounts. In preparing the implementing order, counsel will calculate each amount as of September 30, 2010.

E. The Trust's Remedy For Lost Tax Benefits

If the Trust received insurance proceeds of $1,150,700, then those proceeds would have been excluded from the Trust's taxable income. *See* 26 U.S.C. § 101(a). Delivering tax-advantaged insurance proceeds to Trey was the purpose of the Trust. The parties tersely debated whether the Trust will be forced to pay income tax on damages awarded for the loss of the Policy Value. They have not shed sufficient light on the subject for me to craft a precise monetary award, but the authorities cited and my independent research suggest a significant risk that Eleanor's breaches of fiduciary duty compromised the favorable tax treatment that was a central premise for the Trust.

This Court has broad equitable powers to redress breaches of trust. *See* 12 *Del. C.* § 3581 ("To remedy a breach of trust that has occurred or may occur, the court may order *any* equitable remedy . . . ." (emphasis added)). To the extent the Trust is required to pay income tax on the portion of the damages award attributed to the lost Policy Value, such that the after-tax value of that portion of the award is less than $1,150,700, then Eleanor shall pay an additional sum equal to the amount of the income tax due on that portion of the award. Although I suspect that the make-up payment itself will be taxable, I will not require Eleanor to make recursive payments that would gross-up this portion of the award to $1,150,700. The cost of a gross-up is overly punitive to Eleanor. If the respondents are correct and there are no tax consequences, then no additional payment will be required.

Additional elements of the remedy could be adjusted for tax effects, but the petitioners have not pointed to other significant disparities. More importantly, the Trust does not appear to have been designed to achieve particularly advantageous tax treatment except through the delivery of life insurance proceeds. I therefore will not tax-effect any other aspect of the remedy.

F. Trey's Remedy

In addition to the damages suffered by the Trust, Trey has sued personally for income he should have received. The Manulife shares paid dividends during the period when the Trust would have held them. If the Trust could have sold all of its shares at the closing price on October 31, 2007, then Trey would have received all dividends paid on the shares through the sale date, but would not have received any dividends after that date. The dividends would have been income to the Trust and due to Trey. 12 *Del C.* § 6106(d). Trey is therefore entitled to judgment in the amount of the lost dividends he should have received prior to October 31, 2007. To calculate the income that Trey should have received as a result of each dividend, the parties shall multiply the per share dividend by the number of shares the Trust would have held at the time had the Trust Loan not occurred, depending on whether the dividend was declared pre- or post-split, based on the Trust having received 8,169 shares following the demutualization. For each payment of income that he should have received, Trey is entitled to pre-judgment interest from the ex-dividend date, *see* 12 *Del. C.* § 6104(e), calculated as described above.

Liability for the lost income shall be allocated between Eleanor and Smith. For income resulting from dividends on the 6,261 pre-split Manulife shares that were actually received by the Trust, Eleanor is liable for dividends during her tenure as Trustee, and Smith is liable for dividends during his tenure as Trustee. For all additional income that would have been received on the incremental 1,908 pre-split Manulife shares, Eleanor is liable regardless of when the dividend would have been received. Liability for pre-judgment interest follows liability for the underlying income.

G. An Award Of Attorneys Fees And Expenses Against Eleanor

The petitioners ask that the respondents be ordered to pay their attorneys' fees and expenses. In a judicial proceeding involving a trust, "the court, as justice and equity may require, may award costs and expenses, including reasonable attorney's fees, to any party, to be paid by another party or from the trust that is the subject of the controversy." 12 *Del. C.* § 3584. Whether to award attorneys' fees falls within the discretion of this Court. *McNeil v. McNeil*, 798 A.2d 503, 514 (Del. 2002).

Delaware courts generally follow the American Rule, which holds litigants responsible for their own costs and fees. *See, e.g.*, *Tandycrafts, Inc. v. Initio P'rs*, 562 A.2d 1162, 1164 (Del. 1989). The American Rule recognizes an exception "where the pre-litigation conduct of the losing party was so egregious as to justify an award of attorneys' fees as an element of damages." *Estate of Carpenter v. Dinneen*, 2008 WL 859309, at *17 (Del. Ch. Mar. 6, 2008); *see Arbitrium (Cayman Islands) Handels AG v. Johnston*, 705 A.2d 225, 231 (Del. Ch. 1997), *aff'd*, 720 A.2d 542 (Del. 1998). The pre-litigation conduct must have been in "bad faith, . . . totally unjustified, or the like." *Weinberger v. UOP, Inc.*, 517 A.2d 653, 656 (Del. Ch. 1986); *accord Law v. Law*, 1999 WL 126997, at *1 (Del. Ch. Feb. 24, 1999) (requiring "intentional, unconscionable and egregious conduct"), *aff'd in part, rev'd in part on other grounds*, 753 A.2d 443 (Del. 2000). A lesser breach of fiduciary duty alone will not merit departing from the American Rule. *See HMG/Courtland Props., Inc. v. Gray*, 749 A.2d 94, 124-25 (Del. Ch. 1999).

Eleanor's pre-litigation conduct meets the extreme standard. She repeatedly and consciously sought to harm Trey's interests and serve her own. She tried on multiple occasions to revoke the Trust, and when told that was impossible, resorted to the alternative means of sucking out value through the Trust Loan. She ignored the advice of her counsel and knowingly allowed the Policy to lapse. She knowingly refused to distribute income to Trey and failed to notify him about the Trust so that he could protect his interests. Having intentionally destroyed the bulk of the Trust's value, Eleanor must bear the cost of remedying her breaches of fiduciary duty as an element of damages. Smith's conduct did not rise to that level, and the fee award lies only against Eleanor.

I do not shift fees because of any bad faith litigation conduct by Eleanor's counsel. To the contrary, her counsel responsibly recognized that Eleanor had breached her duties in material respects. That is not to suggest that they conceded the case. Where there was a good faith basis to contest liability, they did so. They also vigorously litigated the appropriate remedy. The fee award does not reflect on them in any way.

Within ten calendar days following this decision, petitioners' counsel will submit to respondents' counsel a demand for attorneys' fees and costs with supporting documents. The demand shall cover the period beginning on August 18, 2009, when Trey was notified about the existence of the Trust, and ending on September 30, 2010. The application shall exclude fees and expenses related to retaining Olson as an expert, because the testimony Olson planned to offer expressed improper opinions on matters of Delaware law, and petitioners ultimately declined to present Olson as an expert witness. If counsel cannot reach agreement on the amount of attorneys' fees and costs to be awarded in the final judgment, then petitioners' counsel shall make an application promptly.

III. CONCLUSION

Judgment is entered in favor of the Trust and Trey and against Eleanor and Smith as set forth above. Counsel shall confer, and petitioners' counsel shall submit an implementing order within twenty calendar days. IT IS SO ORDERED.