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Common Law, Common Sense: Fiduciary Standards and Trustee Identity

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INTRODUCTION

The past twenty years have seen significant changes in the law governing trustees' fiduciary duties. Though fiduciary duty law is a common law creation, recent changes are not a result of common law evolution, but legislative action. The push to codify trust law, including fiduciary duties, has come from several sources, including academics, who have argued that trust law should be more uniform, and banking institutions, which have pushed for legislation to ease the burdens of trust management.

In some significant respects, legislative changes to fiduciary duties have not improved upon the common law. In fact, a few important statutes have replaced theoretically sound common law standards with rules that undermine the historical objectives of trust law. In some instances, scholars have justified changes by claiming that they are necessary to protect the non-professional, poorly counseled trustee. Generally, however, it is the large, institutional trustees that have benefited—significantly—from the statutory changes in the rules.

In this Article, I argue that recent statutes would be much improved if they differentiated between professionals and non-professional trustees. There are critical distinctions between professional and non-professionals: differences in settlors' expectations and objectives, negotiation settings, monitoring costs, and the trustees' responses to liability rules. These distinctions justify having different fiduciary standards for different types of trustees.

Courts, with their case-specific approach to rules, intuitively understand that the identity of the trustee should make a difference in assessing liability for breach of fiduciary duty. Whether expressly or implicitly, courts gradually have developed two sets of rules. Thus,

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changing fiduciary standards to protect the non-professional was never really necessary.

This is not to say that legislation never takes account of the differences between professional and non-professional trustees. For example, the Uniform Prudent Investor Act clearly explains that non-professional trustees should be held to a lower standard of care than professionals, and the delegation rules provide that the status of a trustee is a critical factor in determining whether the trustee properly delegated its duties.[1] However, trust statutes taken as a whole do not reflect consistent attention to this issue.

I argue in this Article that considering non-professional trustees separately from professionals clarifies how fiduciary standards should be crafted best to meet the objectives of trust law. I consider three examples: the duty of loyalty, the delegation rules, and the extent to which the parties to a trust document ought to be permitted to waive or modify fiduciary protections. In each case, the rules should vary depending upon the trustee's identity. In each case, courts have developed an approach to the issue that appropriately takes the identity of the trustee into account. But in each case, new statutory approaches deal with the issue in a less satisfactory way than the common law.

I. Contextual Differences Between Professional and Non-Professional Trustees

In determining how fiduciary rules should be fashioned, it is helpful to first identify some key differences between trusts involving professional versus non-professional trustees. The next section explores, in brief, four key points of difference: the negotiation setting, settlor objectives and expectations, monitoring abilities, and the degree to which the trustee is likely to be influenced by the legal rule. It concludes by setting out separate objectives for governing professional and non-professional trustees.

A. *Differences in Negotiation Settings*

When the settlor engages a professional trustee, the negotiation process is often characterized by stark information asymmetries.[2] On

1 UNIF. PRUDENT INVESTOR ACT § 9 (a) (1994).

2 *See* Melanie B. Leslie, *Trusting Trustees: Fiduciary Duties and the Limits of Default Rules*, 94 GEO. L.J. 67, 85-88 (2005) [hereinafter Leslie, *Trusting Trustees*]. Frank Easterbrook and Daniel Fischel, in arguing that fiduciary duties in the corporate setting are, and should be, freely

one hand, the professional trustee is a repeat player and enjoys economies of scale in understanding what terms are optimal to the trustee and the legal meaning of those terms.[3] The settlor, on the other hand, may have difficulty understanding the meaning of particular terms and how those terms may be interpreted in future circumstances.[4]

In the worst case, the settlor may not be represented by independent counsel. The settlor may instead work with an investment advisor that sets up the trust (with a document drafted by its legal department), explains the document, and then acts as trustee. A trust provision reducing fiduciary duties or exculpating the trustee is inconsistent with the essence of the relationship, which is the trustee's explicit or implicit promise to exercise the highest degree of care and skill, and to devote its energies to advancing zealously the beneficiaries' and not the trustee's interests.[5] The unrepresented settlor, then, may not expect or detect terms that reduce the trustee's duties or insulate it from liability.[6] A settlor is even less likely to expect such a term if she has chosen as trustee a professional with whom she had a pre-existing relationship when the trust was established, such as her investment advisor.[7]

Of course, many prospective settlors are represented by counsel. This fact, however, may not cure information problems at the margins.

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waivable default rules, place great emphasis on market forces that provide information or compensate for information asymmetries between shareholders and directors. *See* FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW (1991). No comparable market forces exist in the trust context.

[3] Leslie, *Trusting Trustees*, *supra* note 2, at 85; *cf.* Jeffrey N. Gordon, *The Mandatory Structure of Corporate Law*, 89 COLUM. L. REV. 1549, 1566 (1989) (arguing that, in the corporate context, "uncertainty about operation of the customized term is likely to run against the prospective shareholder and in favor of the firm" since the firm has greater incentive than the shareholder to understand how a particular customized charter term will operate).

[4] Leslie, *Trusting Trustees*, *supra* note 2, at 85.

[5] John Coffee has argued that the asymmetrical information problem exists in the corporate context, too, and is a critical problem when a shareholder faces a broad waiver of a fiduciary duty; most shareholders will assume that directors will abide by moral constraints for their own sake and out of concern for reputation. John C. Coffee, Jr., *The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role*, 89 COLUM. L. REV. 1618 (1989). "[W]hen legal rules are suspended but nonlegal constraints remain," he states, "the result is to create unproductive uncertainty." *Id.* at 1669. Coffee argues that a mandatory rule prohibiting a waiver that would allow departure from moral norms is efficient. *Id.* at 1669-70.

[6] Bogert, disapproving of corporate trustees' use of exculpatory clauses, notes that the corporate trustee has "advertis[ed] great skill and ability, and impliedly promised to use all that care and capacity in any trust where it is chosen trustee." *See* GEORGE T. BOGERT, TRUSTS 340 (6th ed. 1987).

[7] Indeed the Uniform Trust Code acknowledges as much, imposing on the trustee the burden of proof that the exculpatory clause inserted by the drafter/trustee is "fair under the circumstances" and that "its existence and content" are "adequately communicated to the settlor." UNIF. TRUST CODE § 1008(b) (2005). However, the UTC goes on to gut the protection that this standard ostensibly provides by directing that such a provision is presumed to be fair if the settlor was represented by counsel. *See infra* text accompanying notes 109-12.

Attorneys may be repeat players who seek a stable business relationship with professional trustees. Increasingly, as commercial banks and traditional trust companies lose market share to brokerage firms and other non-traditional trust providers,[8] it is the investment advisor who recommends the attorney who reviews the trust document.[9] These advisors aggressively market trusts to their customers, and are in a position to deliver a steady stream of clients to cooperative lawyers.[10] Although many attorneys will serve their clients ably, those attorneys who have not fully internalized norms of loyalty and honesty face a disincentive to argue too vociferously with institutions who wish to modify fiduciary obligations. This incentive structure has resulted in a rash of recent cases imposing disciplinary sanctions against lawyers.[11]

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8 *See* V. Gerard Comizio & Jeffrey L. Hare, *Regulatory Developments for Banks and Thrifts Conducting Trust and Fiduciary Activities*, 59 BUS. LAW. 1299 (2004). The authors establish that "banks have traditionally dominated the trust market, but personal trust services are now being marketed by a variety of new competitors; as a result, banks have lost market share." *Id.* at 1300. They note that, since the passage of the Gramm-Leach-Bliley Act, financial service companies of all types are increasingly offering trust services. *Id.*; *see also* DIVERSIFIED SERVS. GROUP, INC., PROSPECTUS: TRUST DISTRIBUTION 2002: BUSINESS & DISTRIBUTION MODELS & TACTICS IN THE NON-TRADITIONAL TRUST MARKET (2002) (emphasis omitted), http://www.dsg-candr.com/rmreports/trust_2002_dist.html (stating that "the number of depository institutions with trust powers—and assets under management—decreased by 20.1%" over the three years ending in 1999); *Private Banking . . . Non-Bank Competition Continues to Erode Bank Trust Marketshare*, CONNECTIONS (The LoBue Group, Las Vegas, N.V.), June 1998, *available at* http://www.lobue.com/about_us/about_connections.html (stating that banks are experiencing an "alarming[]" drop in trust business, and that "[s]ince 1990, banks have lost more than half of the 65% market share they once enjoyed").

9 *See, e.g.*, Comm. on Prof'l Ethics & Conduct v. Baker, 492 N.W.2d 695 (Iowa 1992) (reprimanding attorney for accepting over 100 referrals from financial services company establishing living trusts and failing to advise clients in a disinterested fashion).

10 *See* Gerald P. Johnston, *An Ethical Analysis of Common Estate Planning Practices—Is Good Business Bad Ethics?*, 45 OHIO ST. L.J. 57, 115-25 (1984). Professor Johnston explains:

> It is a widespread practice among corporate fiduciaries to retain the services of the lawyer who drafted a will or trust in which a bank is named as executor or trustee to perform any legal work that may be necessary in estate or trust administration. In probating a testator's estate, legal services are virtually always needed because of the strict application of laws relating to unauthorized practice of law, which preclude corporate fiduciaries from handling matters processed through the probate court system. The policy of retaining the draftsman to provide legal services has been described as a "gentlemen's agreement" between financial institutions and the bar, as "reciprocal back scratching," as a "symbiotic relationship," and, less generously, as a "conspiracy" between corporate executors and lawyers to exploit the client by recommending that the testator name a bank as executor in exchange for assurance that the executor, once appointed, will retain the attorney to assist in the probate of the testator's estate.

Id. at 115 (footnotes omitted).

Although this arrangement appears to give the attorney power over the trustee (because the trustee wants to induce the attorney to bring it business), it does not seem beyond the pale to suppose that some attorneys engaged in this type of symbiotic relationship might agree to trust terms simply to keep the relationship on an even keel.

11 *See, e.g.*, People v. Laden, 893 P.2d 771 (Colo. 1995) (publicly censuring attorney for

When information problems exist, settlors may agree to trust terms that are not wealth-enhancing for the trust.

The asymmetrical information problem is less likely to exist when the settlor chooses as trustee a non-professional associate or family member. In this situation, the settlor chooses the trustee because the trustee has a relationship with the settlor and the objects of the settlor's bounty, and can be trusted to make discretionary decisions about the beneficiaries' respective needs. Neither the trustee nor the attorney, if any, is a repeat player. Individual trustees of this sort are unlikely to be trustees of other trusts, are less likely to participate in drafting the trust's terms, and are likely to be on a level playing field with the settlor in terms of sophistication.[12] When the settlor chooses a non-professional trustee, therefore, information problems are unlikely to be significant. Trust terms that modify fiduciary duties in a specific, narrowly tailored fashion are likely to be wealth enhancing.

B. *Differences in Monitoring Costs*

When the trustee is a professional, monitoring can be quite costly. With the exception of regulators, the trustee is largely immune from outside pressures.[13] Because trust agreements are private, the beneficiaries become the sole monitors of the trustee's behavior. Many are ill-equipped to read and evaluate complicated financial disclosure forms, or to second-guess the professional trustee's investment decisions.[14] Indeed, to evaluate whether the trustee is exercising the requisite level of care, the beneficiary would need to possess the same level of expertise and skill as the trustee itself.[15] Because breaches of

aiding trust marketer in the unauthorized practice of law by issuing standard form advice letters in response to trust marketer's clients' requests for legal advice); Comm. on Prof'l Ethics & Conduct v. Matias, 521 N.W.2d 704 (Iowa 1994) (suspending lawyer's license for accepting referrals from company that marketed living trusts); *In re* Mid-Am. Living Trust Assocs., 927 S.W.2d 855 (Mo. 1996) (enjoining living trust company, which sold living trust kits to clients and recommended attorneys to those clients, from doing business in Missouri); Cincinnati Bar Assoc. v. Kathman, 748 N.E.2d 1091 (Ohio 2001) (suspending attorney from practicing law for aiding trust marketer in the unauthorized practice of law and failing to render meaningful legal advice to trust marketer's customers).

12 Leslie, *Trusting Trustees*, *supra* note 2, at 87.

13 Fiduciaries are influenced, not just by liability rules, but by social norms. The liability rule makes no difference to the fiduciary who has internalized the social norm of loyalty, because loyal behavior is a character trait. When a fiduciary has failed to internalize a norm, then she will engage in a cost/benefit analysis in considering whether to act disloyally. She will weigh the chances and consequences of getting caught against the profit she will make if the transaction goes undetected.

14 *See* Leslie, *Trusting Trustees*, *supra* note 2, at 84-85.

15 *See* Robert H. Sitkoff, *Trust Law, Corporate Law, and Capital Market Efficiency*, 28 J.

the duty of loyalty often involve trustee self-dealing with closely related entities, the beneficiary must understand a complex ownership structure and the identity of the trustee's many affiliates, and be able to determine if the trustee's self-dealing is harmful to the trust.[16]

Monitoring of the non-professional trustee may be less costly. Because non-professional trusteeships often arise in the context of closely-knit family situations, the bonds of love and trust often induce trustees to perform with care and loyalty. In addition, beneficiaries' monitoring tasks may be easier: first, close personal relationships give rise to frequent contact. Moreover, because the non-professional is held to a lower standard of care, deviation from that standard may be easier to evaluate. Finally, the self-dealing transactions of the non-professional trustee are generally of a type that are relatively easy to detect, usually involving trustees who borrow or misappropriate trust assets.

C. *Differences in the Impact of Liability Rules*

Liability rules play an important role in governing the behavior of professional trustees. Professionals know, or certainly should know, the substance of the rules that apply to their profession.[17] Most are advised

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CORP. L. 565, 573 (2003); RESTATEMENT (THIRD) OF TRUSTS § 78 cmt. b (Tentative Draft No. 6, 2003) (recognizing that beneficiaries' attempts to monitor trustee performance are likely to be "inefficient if not ineffective" because monitoring efforts will be "wastefully expensive" and suffer from a lack of information, resources, and necessary knowledge and experience).

16 *See* Melanie B. Leslie, *In Defense of the No Further Inquiry Rule: A Response to Professor John Langbein*, 47 WM. & MARY L. REV. 541, 559-60 (2005) [hereinafter Leslie, *No Further Inquiry Rule*].

17 This is not to say that all professional trustees need the incentive provided by a liability rule. Fiduciary standards are legal expressions of obligational social norms. Social norms are standards that are sufficiently ingrained in the culture so that transgression causes self-censure or condemnation by others. *See* Melvin A. Eisenberg, *Corporate Law and Social Norms*, 99 COLUM. L. REV. 1253, 1257 (1999) (explaining obligational norms); *id.* at 1265-66 (explaining that fiduciary duties are obligational norms). Eisenberg divides social norms into three categories: 1) behavioral patterns "that neither entail a sense of obligation nor are self-consciously adhered to or engaged in"; 2) practices that are "self-consciously engaged in" but "do not involve a sense of obligation"; and 3) obligational norms, which are "rules or practices that actors not only self-consciously adhere to or engage in, but feel obliged in some sense to adhere to or engage in." *Id.* at 1256-57. Eisenberg explains that moral norms are one type of obligational norm. *Id.* at 1257. Many, if not most, trustees have internalized these norms; that is, they comply because it is "the right thing to do," even if compliance requires them to forego personal gain. When people have internalized norms, the norms, not legal rules, influence and shape behavior.

Some actors, however, do not internalize particular social norms. For these actors, the decision whether to transgress entails a cost-benefit analysis, which includes an assessment of the chance of getting caught and the social and legal penalties that would result. As Cass Sunstein puts it, "[w]hen defection violates norms, defectors will probably feel shame, an important motivational force." *See* Cass R. Sunstein, *Symposium: Law, Economics, & Norms: On the* by counsel on a regular basis. Non-professional trustees, on the other hand, probably grasp the broad contours of fiduciary norms; they know that misappropriating trust funds is wrong, or that failing to pay attention to investments is problematic. But because they are generally un-counseled, they are less likely to be aware of the specifics of particular trust rules. Thus, a change in the legal rule will probably affect the professional trustee's behavior, but not the behavior of the non-professional.

D. *Differences in Settlors' Objectives*

Settlors and trustees cannot draft agreements that accurately anticipate and resolve all future conflicts.[18] When the parties have failed to stipulate how the trustee should respond to future events, fiduciary duties provide guidance. Fiduciary duties are best understood as the terms that the parties would have agreed to ex ante if they had anticipated the future conflict and bargaining was costless.[19]

Settlors have different reasons for choosing, and different expectations about the performance of, professional or non-professional trustees. Consequently, fiduciary standards should vary depending on the trustee's identity.

Settlors choose professionals because they purport to be experts at managing trust assets and effectuating settlors' long-term objectives. For a fee, the expert promises to advocate zealously for the beneficiaries' interests and to subordinate the trustee's interests to those of the trust. The settlor who chooses the professional trustee expects the highest level of professionalism and care.

Settlors generally have different motivations for choosing non-professional trustees. Settlors choose non-professionals because they trust their ability to make distribution decisions and deal with family conflicts. Most settlors expect non-professionals to act in good faith and to exercise honest judgment; they may not expect non-professional trustees to possess a professional's ability to invest or an expert's knowledge of the law.

Expressive Function of Law, 144 U. PA. L. REV. 2021, 2029-30 (1996). Legal rules, therefore, can play an important role in enforcing compliance with social norms when people have failed to internalize those norms.

[18] *See* EASTERBROOK & FISCHEL, *supra* note 2, at 92; Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 J.L. & ECON. 425, 426 (1993).

[19] EASTERBROOK & FISCHEL, *supra* note 2, at 92; Easterbrook & Fischel, *supra* note 18, at 426; *see also* Sitkoff, *supra* note 15, at 577 (positing that "[i]nstead of getting bogged down in the impossibility of specifying conduct ex ante, fiduciary duties supply liability rules that call for an 'ex post settling up' in accordance with what the parties would have bargained for in advance").

E. *Ramifications*

In sum, when the trustee is a professional, the settlor seeks an expert level of care and loyalty. Fiduciary rules should encourage that behavior. Because significant information and monitoring problems may exist, fiduciary rules for professional trustees should seek to force disclosure in trust creation and management.

Because non-professionals often will be ignorant of the particulars of fiduciary rules, such rules will be less likely to affect their behavior. Rules designed to force disclosure will not achieve their objectives. Because information and monitoring problems generally are not severe when the trustee is a non-professional, the rules' ineffectiveness is not cause for concern. Instead, rules governing non-professional trustees should focus more on effectuation of the settlor's intent.

In the following section, I build on these insights to explore how fiduciary standards should differ depending on the trustee's identity.

II. LIABILITY RULES

A. *The Duty of Loyalty*

1. Different Standards for Different Trustees

A trustee breaches its duty of loyalty when it personally profits from transacting business with the trust.[20] As the following sections demonstrate, the standard for determining trustee liability for such a breach should vary depending on whether the trustee is a professional or non-professional. Over time, case law has evolved to take account of this difference.[21] A review of cases from the last decade establishes that courts generally do not hold non-professional trustees liable for self-dealing acts taken in good faith to benefit the trust.[22] Professional trustees, however, are subject to the no further inquiry rule, which requires them to obtain advance approval prior to transacting with the

20 *See* RESTATEMENT (THIRD) OF TRUSTS § 78(1) cmt. d (Tentative Draft No. 6, 2003); RESTATEMENT (SECOND) OF TRUSTS § 170(1) cmts. c, *l* (1959).

21 *See supra* notes 2-19 and accompanying text.

22 *See* cases cited *infra* note 54.

trust. In the following sections, I develop an analytical framework to explain why this doctrinal development is sound.

Unfortunately, the legislatures and drafters of model statutes have taken a path that is radically different than the courts' approach. First, although statutory changes often have been justified as necessary to protect the non-professional trustee,[23] statutes offer non-professionals no additional protections beyond those that they would receive from courts. In fact, to the extent that courts interpret new loyalty provisions as repudiating common law doctrine, statutory changes could leave the non-professional trustee with even less protection.[24] Second, and more importantly, statutory changes to the duty of loyalty have produced significant benefits for professional trustees, especially those of the large institutional type. Although section 8 of the Uniform Trust Code (the UTC or the "Code") begins by restating the no further inquiry rule, it loosens its grip on institutional trustees in sections 802(c)(4) and 802(f), which exempt from the rule most types of self-dealing in which institutional trustees would seek to engage.[25] Instead, institutional trustees can self-deal without advance approval, and will escape liability if they can show that the transaction was fair to the trust.[26] In many

[23] John H. Langbein, *Questioning The Trust Law Duty Of Loyalty: Sole Interest Or Best Interest?*, 114 YALE L.J. 929 (2005).

[24] Specifically, section 802(c)(4) of the Uniform Trust Code, taken literally, codifies the no further inquiry rule for non-professional trustees who transact with the trust. Although comments to the UTC indicate that the common law remains in effect, courts in adopting states might decide that the new statute should be applied according to its plain language.

[25] UNIF. TRUST CODE § 802(b) (2005) states that "a sale, encumbrance, or other transaction involving the investment or management of trust property entered into by the trustee for the trustee's own personal account or which is otherwise affected by a conflict between the trustee's fiduciary and personal interests is voidable by a beneficiary . . . ," whereas section 802(c)(4) states that:

> [a] sale, encumbrance, or other transaction involving the investment or management of trust property is presumed to be affected by a conflict between personal and fiduciary interests if it is entered into by the trustee with: . . . (4) a corporation or other person or enterprise in which the trustee, or a person that owns a significant interest in the trustee, has an interest that might affect the trustee's best judgment.

Section 802(f) provides:

> An investment by a trustee in securities of an investment company or investment trust to which the trustee, or its affiliate, provides services in a capacity other than as trustee is not presumed to be affected by a conflict between personal and fiduciary interests if the investment complies with the prudent investor rule of [Article] 9. The trustee may be compensated by the investment company or investment trust for providing those services out of fees charged to the trust if the trustee at least annually notifies the persons entitled under Section 813 to receive a copy of the trustee's annual report of the rate and method by which the compensation was determined.

[26] The comment to UTC section 802 states:

> Under subsection (c), a transaction between a trustee and certain relatives and business associates is *presumptively voidable, not void*. Also presumptively voidable are transactions with corporations or other enterprises in which the trustee, or a person who owns a significant interest in the trustee, has an interest that might affect the trustee's

states, the UTC's adoption has repealed, or is poised to repeal, statutes that expressly required trustees to obtain advance approval prior to self-dealing.[27] The UTC relieves institutional trustees of the burden of making full disclosure ex ante, and places the burden of detecting and objecting to the self-dealing behavior squarely on the beneficiary.

In the following paragraphs, I explain the no further inquiry rule and show why it continues to serve an important function with respect to professional trustees. I also argue that replacing the no further inquiry rule with corporate law's "best interests" defense is unwise because significant differences between the corporate and trust law settings require different rules. Finally, I analyze whether the no further inquiry rule is equally appropriate for non-professional trustees, and conclude that it may be inappropriate. I also establish that my analysis is descriptive as well as normative: in recent decades, case law has evolved to create different liability rules for professional and non-professional trustees who self-deal. Finally, I turn to recently enacted statues, including the UTC, and explore how those statutes should be amended to be consistent with my analytical framework.

a. Professional Trustees and the No Further Inquiry Rule

> best judgment. The presumption is rebutted if the trustee establishes that the transaction was not affected by a conflict between personal and fiduciary interests. Among the factors *tending to rebut the presumption* are *whether the consideration was fair* and whether the other terms of the transaction are similar to those that would be transacted with an independent party.

UNIF. TRUST CODE § 802 cmt. (2005) (emphasis added).

27 The Uniform Trustee Powers Act (U.T.P.A.) states, "[i]f the duty of the trustee and his individual interest, or his interest as trustee of another trust, conflict in the exercise of a trust power, the power may be exercised only by court authorization." UNIF. TRUSTEE POWERS ACT § 5 (1964). Although not widely adopted, of the sixteen states that adopted the U.T.P.A., ten have since adopted the UTC, repealing this provision of the U.T.P.A. The following states adopted the Uniform Trustee Powers Act in full or a substantially similar version: Arizona (ARIZ. REV. STAT. ANN. § 14-7235 (2005)), Florida (FLA. STAT. ANN. § 737.403 (West 2006)), Hawaii (HAW. REV. STAT. § 554A-5 (2004)), Idaho (IDAHO CODE ANN. § 68-108 (2005)), Kansas (KAN. STAT. ANN. 58-1201 to 11 (repealed 2002)), Kentucky (KY. REV. STAT. ANN. § 386.820 (West 2006)), Maine (ME. REV. STAT. ANN. tit.18-A, § 7-404 (repealed 2003)), Michigan (MICH. COMP LAWS ANN. § 700.7403 (West 2006)), Mississippi (MISS. CODE ANN. § 91-9-111 (2006)), Nebraska (NEB. REV. STAT. § 30-2819 to 26 (repealed 2002)), New Hampshire (N.H. REV. STAT. ANN. § 564-A:1 to A:11 (repealed 2004)), New Mexico (N.M. STAT. ANN. §45-7-401 (repealed 2003)); OR. REV. STAT. § 128.003 to .051 (repealed 2005)), South Carolina (S.C. CODE ANN. § 62-7-706 (2005)), Utah (UTAH CODE ANN. § 75-7-401 to 409 (2005)), and Wyoming (WYO. STAT. ANN. § 4-8-101 to 4-8-1122 (repealed 2003)). Florida, Kansas, Maine, Nebraska, New Hampshire, New Mexico, Oregon, South Carolina, Utah, and Wyoming all have since adopted the UTC. *See* Unif. Law Comm'rs, A Few Facts About the Uniform Trust Code, http://www.nccusl.org/Update/uniformact_factsheets/uniformacts-fs-utc2000.asp (last visited Mar. 21, 2006).

Trust law has long imposed a bright-line prohibition against trustee self-dealing.[28] Historically, a trustee could profit from its position only if the settlor had expressly authorized it or if the trustee had obtained authorization to act from the court or the beneficiaries.[29] Any unauthorized transaction involving the trust and the trustee personally constituted a breach of the duty of loyalty and was voidable by the beneficiary, even if the trustee's action did not damage the trust.[30] When the trustee engaged in self-dealing, the beneficiaries were entitled to choose among a variety of remedies: in addition to rescinding the transaction, beneficiaries could seek damages or, more importantly, require the trustee to pay all of its profits to the trust.[31] Beneficiaries could also seek to have the trustee removed.[32]

This clear rule prohibiting the trustee's personal interaction with the trust was known as the "no further inquiry rule." The rule's unique feature was its strict liability aspect: the trustee had no defense. In marked contrast to corporate law, the trustee was held liable even if the transaction was fair to the trust or in the trust's best interests. The rule was equally applicable to transactions that benefited third persons whose interests were intermingled with the trustee's.[33] The trustee was prohibited from engaging in transactions with her close family members or firms in which she had an interest.[34] Historically, professional trust companies could not transact business with related firms.[35]

There is little doubt that the move away from the no further inquiry rule has been influenced by a similar trend in corporate law.[36] Although

[28] RESTATEMENT (SECOND) OF TRUSTS § 170(1) cmts. a, *l* (1959). The most recent preliminary draft of the Restatement (Third) affirms the Restatement (Second)'s approach to the duty of loyalty in the main, but recognizes (and thus seems to validate) a troubling new loophole for institutional trustees that threatens to undermine the duty of loyalty. *See* RESTATEMENT (THIRD) OF TRUSTS § 78(1) cmt. d (Tentative Draft No. 6, 2003) (affirming the duty of loyalty generally); *id.* cmt. c(8) (noting that state statutes allow institutional trustees to invest trust assets in proprietary mutual funds).

[29] *See* RESTATEMENT (THIRD) OF TRUSTS § 78 cmt. a (Tentative Draft No. 6, 2003) (stating that the "duty of loyalty is, for trustees, particularly strict even by comparison to the standards of other fiduciary relationships").

[30] *See* RESTATEMENT (THIRD) OF TRUSTS § 78 cmt. b (Tentative Draft No. 6, 2003) (stating that under the no further inquiry rule "it is immaterial that the trustee may be able to show that the action in question was taken in good faith, that the terms of the transaction were fair, and that no profit resulted to the trustee").

[31] 2 AUSTIN WAKEMAN SCOTT, THE LAW OF TRUSTS §§ 170.2, 206 (1939); BOGERT, *supra* note 6, § 95.

[32] BOGERT, *supra* note 6, § 95.

[33] *See* RESTATEMENT (THIRD) OF TRUSTS § 170 cmts. c, d, h, i (1992); SCOTT, *supra* note 31, §§ 170.6, 170.10, 170.11, 170.13; BOGERT, *supra* note 6, § 95.

[34] *See* RESTATEMENT (THIRD) OF TRUSTS § 170 cmts. c, d, h, i (1992); SCOTT, *supra* note 31, §§ 170.6, 170.10, 170.11, 170.13; BOGERT, *supra* note 6, § 95.

[35] *See* RESTATEMENT (THIRD) OF TRUSTS § 170 cmts. c, d, h, i (1992); SCOTT, *supra* note 31, §§ 170.10, 170.11, 170.13; BOGERT, *supra* note 6, § 95.

[36] Langbein, *supra* note 23.

at the turn of the twentieth century self-interested transactions were voidable by shareholders,[37] the rule soon evolved to allow directors or management to escape liability for breach of the duty of loyalty by showing that the transaction was "fair to" or "in the best interests of" the corporation.[38] Leaving aside the issue of whether the change in corporate law was a good one, the trust mechanism is distinct from a corporation in ways that explain why trust law stubbornly held on to the no further inquiry rule long after corporate law abolished it. In the following paragraphs, I explain why the no further inquiry rule is superior to the best interests defense as a liability rule for professional trustees.

There are two key differences between the no further inquiry rule and the best interests defense. The first difference is in the monitoring costs created by each rule. The second concerns the impact that each rule has on supporting social norms.

i. Monitoring Costs

Because beneficiaries and shareholders often detect duty of loyalty violations only after the fact, deterrence of disloyal behavior depends on the ease with which the beneficiaries or shareholders can hold the fiduciary liable. The best interests defense creates significantly greater costs for beneficiaries/shareholders, and thus provides less of a deterrent, than the no further inquiry rule.[39]

The no further inquiry rule puts the burden of exposing the conflict, providing information, and making the case that the transaction is in the trust's best interests squarely on the fiduciary.[40] The beneficiary's monitoring tasks are limited to evaluating the information before her and monitoring to ensure that the fiduciary is not benefiting from its position of trust without advance approval. The latter task requires only that the beneficiary determine whether the trustee or a

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37 *See* Deborah A. DeMott, *The Figure in the Landscape: A Comparative Sketch of Directors' Self-Interested Transactions*, 62 LAW & CONTEMP. PROBS. 243, 252-53 (1999) (noting that "any contract between a director and the corporation [was] voidable at the corporation's insistence" and that later, "courts may have believed that substantive judicial review [was] more likely to detect problematic transactions than [was] submission to shareholders").

38 *See* MODEL BUS. CORP. ACT § 41 (1981) (providing that an interested transaction can be validated if it is "fair and reasonable to the corporation"); *see also* 18 AM. JUR. 2D *Corporations* § 1504 (2006) (noting that although some statutes recognize the validity of a board resolution approving a self-interested transaction, such transactions may be avoided if they are "unfair and unreasonable to the corporation"); *id.* § 1738 (citing MODEL BUS. CORP. ACT § 41 (1969)).

39 *See* Leslie, *No Further Inquiry Rule*, *supra* note 16, at 554-67.

40 *Id.* at 564.

related company has a personal interest in a transaction with the trust. If so, the beneficiary has a claim for breach.

By contrast, the best interests defense imposes significantly greater monitoring costs on the beneficiary/shareholder.[41] Because the rule does not require advance approval, trustees seldom will present beneficiaries with the information the beneficiaries need to evaluate self-dealing transactions. The beneficiary must not only detect self-dealing transactions, but also expend resources gathering information to evaluate them. Because this rule does not impose automatic liability, the beneficiary's monitoring task is further increased: she must evaluate the transaction to determine whether a court would likely find that the transaction is fair to the corporation.

In the corporate context, a rule that is more costly in terms of monitoring expenses may not be troubling because market forces support and supplement shareholders' monitoring efforts.[42] Strong information markets exist, and fiduciaries' performance is reflected, in some measure, in stock price.[43] More importantly, shareholders can monitor collectively—some number of shareholders will be financially sophisticated, and large institutional investors have strong incentives to monitor fiduciary performance.[44] Small investors can free ride on those efforts.[45] If a particular board member or officer wishes to engage in self-dealing, other board members have an incentive to scrutinize the deal to make sure it is fair to the corporation. As a result, significant, unauthorized self-dealing is often detected. All of these forces together pressure corporate fiduciaries to conform to fiduciary standards.

By contrast, professional trustees face little to no market pressure.[46] Trust documents and management decisions are private, and neither information markets nor share prices evaluate trustee performance. The entire task of monitoring falls on a few beneficiaries,

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[41] *Id.* at 565.

[42] *See* EASTERBROOK & FISCHEL, *supra* note 2, at 21 (stating that if corporate charters contain disadvantageous terms, "management will pay as investors go elsewhere"); Gordon, *supra* note 3, at 1563-65 (arguing that stock price does telegraph information about charter terms); Henry N. Butler & Larry E. Ribstein, *Opting Out of Fiduciary Duties: A Response to the Anti-Contractarians*, 65 WASH. L. REV. 1, 33-45 (1990) (arguing that markets are efficient and that corporate terms are fully reflected in stock price, and concluding that "the presence of play in the corporate contract suggests, rather than a failure of contracting, a recognition that the least costly way of dealing with agency costs may be to allow them to be checked by incentive or monitoring devices instead of by liability rules").

[43] *See* Butler & Ribstein, *supra* note 42, at 33-45.

[44] *Id.*

[45] EASTERBROOK & FISCHEL, *supra* note 2, at 18-22 (stating that "the price of stocks traded in public markets is established by professional investors, not by amateurs" and, drawing on other academic literature, arguing that stock price reflects the value of charter terms, which protects uninformed investors); *see also* Gordon, *supra* note 3, at 1558-59.

[46] Leslie, *Trusting Trustees*, *supra* note 2, at 82-84.

who must bear a greater proportionate share of the monitoring costs than shareholders bear. In addition, it is probably a safe generalization to say that beneficiaries as a whole are poorer monitors than shareholders. Many beneficiaries lack financial acumen, and there is nothing equivalent to the institutional investor on which the less sophisticated beneficiary can free ride. Thus, the trust context presents significantly less monitoring, and poorer quality monitoring, than does the corporate context.[47] Because of this disparity, a rule that places the burden of disclosure on the trustee makes more sense than one that places it on the beneficiary.

ii. The Impact of Liability Rules

The monitoring difficulties inherent in the trust context make it less likely that a fiduciary's opportunistic behavior will be detected. It is therefore more important that the liability rule create the strongest possible deterrent to disloyal behavior. The no further inquiry rule sends the clearest possible message to trustees:[48] do not profit from your position without obtaining advance approval.[49] The remedies afforded by the rule are designed to make the stakes for breaching high—the trustee who stands to lose profits and face removal might think twice before engaging in self-dealing. In many states, the advance approval doctrine has also been codified, which provides even clearer warnings.[50]

The corporate standard, on the other hand, sends a murkier message. When some types of opportunism are allowed, fiduciaries, particularly those who have not internalized social norms of loyalty, may push the boundaries of allowable behavior or rationalize behavior that is clearly questionable. In the corporate context, where market discipline is stronger, this fuzziness may not be as troubling. When monitoring is lacking, it is unwise. Thus, the no further inquiry rule is the best rule to apply to professional trustees.

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[47] For a discussion on the differences in the monitoring capabilities of beneficiaries and shareholders, see Leslie, *Trusting Trustees*, *supra* note 2, at 77-88.

[48] The clearer the rule, the easier it is transmitted and understood. *See* **Error! Main Document Only.**Meir Dan-Cohen, *Decision Rules and Conduct Rules: On Acoustic Separation In Criminal Law*, 97 HARV. L. REV. 625 (1984).

[49] As Robert Cooter and Bradley Friedman note, "[t]he duty of loyalty must be understood as the law's attempt to create an incentive structure in which the fiduciary's self-interest directs her to act in the best interest of the beneficiary." *See* Robert Cooter & Bradley J. Friedman, *The Fiduciary Relationship: Its Economic Character and Legal Consequences*, 66 N.Y.U. L. REV. 1045, 1074 (1991).

[50] *See supra* note 27.

b. The Non-Professional Trustee's Duty of Loyalty

Historically, the no further inquiry rule applied equally to professional and non-professional trustees, at least in theory. A strong case can be made, however, that the rule is an inappropriate liability rule for non-professional trustees. First, beneficiaries' monitoring tasks may be less costly: because non-professional trusteeships often arise in the context of closely knit family situations, love, affection, and trust often do the work that market pressures perform in the corporate setting. Close personal relationships also give rise to frequent contact. More importantly, the self-dealing transactions of the non-professional trustee are of a type that are relatively easy to detect, usually involving trustees who borrow or misappropriate trust assets. This is in contrast to self-dealing transactions by corporate trustees, which often involve transactions between the trust and various corporate entities in which the corporate trustee has an interest. To detect self-dealing in this case, the beneficiary must understand a complex ownership structure and the identity of the trustee's many affiliates in addition to detecting the transaction.[51]

Another factor justifying an exception for non-professional trustees is the fact that non-professionals generally lack knowledge of the no further inquiry rule. Unlike a professional trustee, which should be expected to understand the liability rules governing its profession, the non-professional may receive inadequate or no legal advice.[52] Imposing liability or other sanctions against a trustee whose actions were taken in good faith and fair to the trust furthers neither the settlor's nor the no further inquiry rule's objectives: Most settlors expect good faith and honest judgment, but not an expert's knowledge of the law. Moreover, holding non-professionals strictly liable does not advance the rule's objectives of creating the strongest possible deterrent to self-dealing; the rule cannot deter those who are unaware of it.[53]

In addition, a significant number of trusts with non-professional trustees are family trusts that create a built-in conflict of interest between the trustee's fiduciary obligations and personal interests. For example, a settlor may create a by-pass or credit-shelter trust, naming her spouse as trustee and income beneficiary with limited rights to

[51] Leslie, *No Further Inquiry Rule*, *supra* note 16, at 559.

[52] Langbein, *supra* note 23, at 963.

[53] For a discussion and examples of alternate reading of case law, see Leslie, *No Further Inquiry Rule*, *supra* note 16, at 554 ("These cases provide peculiar evidence of overdeterrence, because the trustees were not deterred; they simply engaged in self-dealing without obtaining advance approval. That is, these cases involved trustees who did not know the law, and who would not have responded to incentives.").

principal distributions, and her children as remaindermen. Or, a settlor might devise shares of a family-owned corporation in trust to benefit his descendants, and name a child who controls the company as trustee with the power to vote the trust's shares. In these situations, that the trustee will take actions that benefit herself is practically guaranteed; applying the no further inquiry rule to impose liability when the trustee does not understand the need to obtain advance approval surely would frustrate the settlor's intent.

2. Common Law, Common Sense

The case can be made, then, that non-professional trustees should be judged differently than professionals when they transact with the trust without obtaining advance approval. Increasingly, courts are recognizing as much. A review of case law over the past decade establishes that not one court has removed a non-professional trustee or imposed personal liability for self-dealing without advance approval when the trustee's self-interested transaction was a good faith attempt to benefit the trust and effectuate the settlor's objectives.[54] On the other hand, courts find that trustees have breached their duty of loyalty when a reasonable person should have known that the self-dealing act would

[54] *See* Beattie v. J.M Tull Found., No. 97-2746, 1999 WL 222406 (4th Cir. Apr. 16, 1999) (reversing district court to hold that trustee who, in good faith, cashed out life insurance policies and distributed them to his incapacitated aunt, thereby increasing her estate that he inherited and depleting remaindermen's share, did not breach duty of loyalty because trustee was attempting to carry out settlor's intent); Tays v. Metler, No. 97-2317, 1999 WL 149661 (10th Cir. Mar. 19, 1999) (holding that husband/trustee of by-pass trust did not breach duty of loyalty when he sold his personal property to the trust for cash, because his actions were in good faith and were consistent with settlor's purpose in establishing the by-pass trust); Helman v. Mendelson, 769 A.2d 1025 (Md. Ct. Spec. App. 2001) (declining to remove family trustees who borrowed money from the trust because the transactions were fair, trustees acted in good faith, and they repaid the loans); Massara v. Henery, No. 19646, 2000 WL 1729457 (Ohio Ct. App. Nov. 22, 2000) (affirming trial court's grant of summary judgment in favor of two family trustees who sold the beneficiary's interest in the family business back to family partnership (of which trustees were partners), without beneficiary's consent, in exchange for the partnership's promise to pay to the trust a fixed sum over six years because trustees were motivated by a desire to guarantee the beneficiary a steady income and to prevent him from obtaining additional funds from the trust to fuel his drug habit); Warehime v. Warehime, 761 A.2d 1138 (Pa. 2000) (reversing appellate court's application of the no further inquiry rule to find that trustee/son who voted trust's shares to preserve his control over family corporation did not breach his duty of loyalty to trust beneficiaries). *But cf.* Kinzel v. Kinzel, C.A. No. 95CA006122, 1996 WL 121997 (Ohio Ct. App. Mar. 20, 1996) (holding that trial court improperly granted summary judgment in favor of trustee, where trustee held proceeds from sale of trust property in trustee's personal bank account, and remanding for a determination whether this act constituted a breach of the duty of loyalty; a proper application of the no further inquiry rule would have eliminated the need for remand to consider the fairness of the transaction, and would have resulted in automatic liability).

not benefit the trust.[55] Although courts are not always clear about what standard they are applying, several courts have expressly rejected beneficiaries' arguments that the no further inquiry rule should apply to non-professional trustees.[56] Indeed, research indicates that in the past decade only two appellate courts have approved the application of the no further inquiry rule to a non-professional trustee—and in neither of those cases did the trustee suffer personal liability or removal for the mere fact of self-dealing.[57]

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55 For example, in *Feinberg v. Adolph K. Feinberg Hotel Trust*, 922 S.W.2d 21 (Mo. Ct. App. 1996), the trustee remaindermen, sons of the settlor, failed to make significant income distributions to their mother, the income beneficiary, and almost entirely depleted the trust corpus by making themselves unsecured loans on extraordinarily favorable terms (on which they defaulted) in order to fund their business ventures. In addition to awarding damages, the court directed the trustees to pay the income beneficiary's attorney's fees. *See also* Sanford v. Sanford, 355 Ark. 274 (2003) (holding that husband/trustee breached duty to ex-wife beneficiary when he took unauthorized trustee compensation and sold trust property and kept her share of the proceeds to repay her alleged debts to him, which left her with no funds to pay capital gains tax); Hosey v. Burgess, 319 Ark. 183 (1995) (trustee/remainderman breached duty by subleasing trust property and keeping the profit); Sullivan v. Hellgren, No. B164017, 2004 WL 831178 (Cal. Ct. App. Apr. 19, 2004) (finding trustee/beneficiary breached duty to brother/beneficiary by transferring family home from trust to herself, selling the home, keeping the proceeds, and rendering the trust worthless); White v. Pierson-Anderson (*In re* Estate of Heyn), 47 P.3d 724 (Colo. Ct. App. 2002) (stating that when the beneficiary can show self-dealing, the trustee can rebut the charge by showing that the transaction was fair and reasonable, and finding trustee liable because he lived rent-free in the apartment building that was held in trust); Aiello v. Hyland, 793 So. 2d 1150 (Fla. Dist. Ct. App. 2001) (awarding damages and removing trustee who attempted to sell trust property at below-market value to brother with whom trustee was in business); Deutsch v. Wolff, 994 S.W.2d 561 (Mo. 1999) (upholding determination that trustee was liable on an outstanding loan from trust to partnership in which trustee and one beneficiary were partners); John R. Boyce Family Trust v. Snyder, 128 S.W.3d 630 (Mo. Ct. App. 2004) (holding trustee liable for breach of fiduciary duty because he convinced beneficiary to consent to the use of trust assets to buy a store from trustee by misrepresenting his reasons for selling and the store's financial position; store went bankrupt); Coffey v. Coffey, 286 N.J. Super. 42 (App. Div. 1995) (finding settlor/trustee of trust for divorced settlor's children liable for breach of duty of loyalty when he improperly used trust assets to satisfy his personal financial obligations to his children, used trust funds to pay his legal bills, and co-mingled trust assets with his own); *In re* Dentler Family Trust, 873 A.2d 738 (Pa. Super. Ct. 2005) (surcharging co-trustees (settlor's son and his lawyer) for, among other things, trading trust assets on margin to raise cash in order to make a large distribution to trustee's son at the expense of the other trust beneficiaries).

56 *See, e.g.*, *Tays*, 1999 WL 149661 (following the law of several states to hold that when settlor created the conflict of interest between trustee's fiduciary and personal interests, the trustee is liable for breach only when acting in bad faith, dishonestly, or intentionally against the interest of the trust); *Helman*, 769 A.2d at 1051-52 (rejecting beneficiary's claim that the no further inquiry rule should apply when trustee loaned himself trust funds); *Massara*, 2000 WL 1729457 (holding that the no further inquiry was inapplicable and placing the burden on the beneficiary to show that he was damaged by the trustee's action); *Warehime*, 563 Pa. 400 (holding that the appellate court erred as a matter of law in applying the no further inquiry rule because a "good faith" standard was more appropriate).

57 *See* Stegemeier v. Magness, 728 A.2d 557 (Del. 1999) (indicating trustees who sold real property held in trust to themselves, developed it, and sold it at a profit might be found not liable on remand so long as they could demonstrate that they paid fair market value, which, as the dissent pointed out, seemed likely given that trustee's expert trial witness already provided significant evidence in support of that fact); *In re* Estate of Stevenson, 605 N.W.2d 818 (S.D.

In sum, courts are protecting non-professional trustees from liability when doing so effectuates settlors' intent and does not undermine the deterrent effect of the no further inquiry rule. Yet the no further inquiry rule, with its advance approval requirement, is the appropriate rule for professional trustees. Unfortunately, as I establish in the following sections, statutes enacted in recent years fail to address the need for different rules.

3. Statutory Shortcomings

As we have seen, case law is evolving to create two distinct liability rules for professional and non-professional trustees. The past twenty years have seen a surge of interest in codifying the law of trusts. Insofar as codification restates and integrates the common law, it presents few problems. Some key statutes codifying the duty of loyalty, however, significantly depart from, and in some instances entirely repudiate, settled duty of loyalty principles. In particular, statutory departures from the no further inquiry rule create significant benefits for the professional trustee at the expense of the beneficiary, and fail to reflect changes in the case law that protect the non-professional. More troubling, no one has given a persuasive justification for either problem.

a. Uniform Trust Code Section 802 and Exceptions to the No Further Inquiry Rule

Section 802 of the UTC, the duty of loyalty provision, could be significantly improved by giving greater attention to the differences between professional and non-professional trustees. First, a quibble: the Code arguably could afford more protection to the non-professional trustee than it currently does. The comments appropriately acknowledge the plight of the inherently conflicted non-professional trustee and suggest that a settlor's appointment of a conflicted trustee may constitute an implied waiver of the duty of loyalty.[58] However, a

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2002) (applying no further inquiry rule, and allowing beneficiaries to void trustee's leases of trust property to trustee's husband and to trustee's husband's relatives; trustee suffered no personal liability).

[58] Presumably, the comments mean to suggest that a conflicted trustee's acts should be judged by a "best interest of the trust" standard, and not that a conflicted trustee's self-interested acts are per se valid.

non-conflicted non-professional who transacts business directly with the trust without advance approval may be subject to the no further inquiry rule,[59] which the Code affirms is applicable to all trustees except as otherwise provided.[60] Of course, there is a good reason to set out the no further inquiry rule as the black letter law applicable to all trustees: if a non-professional trustee consults a lawyer prior to engaging in a conflicted transaction, it is best if the lawyer advises her to seek advance approval. However, because the statute seems clear on its face, some courts might read it as a repudiation of cases that apply a "best interests" test to actions taken by non-professional trustees. The comments could clarify that the statute does not abrogate common law doctrine.

More troubling, section 802(c) creates an enormous exception from the no further inquiry rule for professional trustees, one that represents a reversal of the common law. The ill-advised loophole seems to be an extension of case law that existed to protect individual trustees. Because the exception makes sense only in the case of non-professionals, the extension to benefit professional trustees is unwarranted.

Specifically, the model statute lists a variety of transactions that give rise to only a rebuttable presumption of improper self-dealing. The trustee may rebut the presumption of self-dealing by establishing that "the transaction was not affected by a conflict between personal and fiduciary interests."[61] In determining whether the trustee has met its burden, the court may consider factors such as "whether the consideration was fair and whether the other terms of the transaction are similar to those that would be transacted with an independent party."[62]

59 UNIF. TRUST CODE § 802(a) (2005).

60 UNIF. TRUST CODE § 802(a) & (b) (2005) provide:

(a) A trustee shall administer the trust solely in the interests of the beneficiaries.

(b) Subject to the rights of persons dealing with or assisting the trustee as provided in Section 1012, a sale, encumbrance, or other transaction involving the investment or management of trust property entered into by the trustee for the trustee's own personal account or which is otherwise affected by a conflict between the trustee's fiduciary and personal interests is voidable by a beneficiary affected by the transaction unless:

(1) the transaction was authorized by the terms of the trust;

(2) the transaction was approved by the court;

(3) the beneficiary did not commence a judicial proceeding within the time allowed by Section 1005;

(4) the beneficiary consented to the trustee's conduct, ratified the transaction, or released the trustee in compliance with Section 1009; or

(5) the transaction involves a contract entered into or claim acquired by the trustee before the person became or contemplated becoming trustee.

61 UNIF. TRUST CODE § 802 cmt. (2005).

62 *Id.*

Thus, for particular transactions, the statute replaces the no further inquiry rule with what is essentially a corporate "fairness" standard. Those transactions include transactions between the trustee and 1) the trustee's spouse, 2) the trustee's relatives, 3) the trustee's agents and attorneys, and 4) "a corporation or other person or enterprise in which the trustee, or a person that owns a significant interest in the trustee, has an interest that might affect the trustee's best judgment."[63] Only exception two has significant, though not solid, support in the common law.[64] Exception one, which finds some support in case law, can be justified as a logical extension of exception two. The comments are silent as to why exceptions were made for the employees, agents, and affiliates of professional trustees.

One possibility is that the drafters simply viewed exceptions three and four as natural extensions of the "indirect self-dealing" rule articulated by Austin Wakeman Scott. According to Scott,

> the mere fact that the purchaser [of trust property] is related to the trustee is not of itself a sufficient ground for voiding the sale. It is, however, a circumstance to be considered in determining whether the sale was made in the best interests of the beneficiaries and if on all the facts it appears that the trustee sold the property for less than he could have obtained from others or otherwise abused his discretion in making the sale, the trustee is guilty of a breach of trust . . . .[65]

The cases that Scott cites as support involve non-professional family trustees or executors who sold trust property to relatives to benefit the estate or trust. This exception to the no further inquiry rule, to the extent it existed,[66] is best understood as courts' attempt to protect the non-professional family fiduciary who dealt fairly with the testator's estate or trust but neglected to obtain advance approval. It is consistent with the idea that the no further inquiry rule should not be applied when doing so would violate the settlor's intent. The exception cannot, however, serve as a basis for shielding professional trustees from liability when they deal with employees, or with related entities in which they have a significant interest.

To the extent the Code's exceptions benefit professional trustees, they are unsound. First, the rule eliminates incentives for professional trustees to bargain with settlors for authorization to deal with related

[63] UNIF. TRUST CODE § 802(c)(4) (2005).

[64] SCOTT, *supra* note 31, § 170.6; BOGERT, *supra* note 6, § 95. There are some courts that recognize the spouse exception, however others have soundly rejected it.

[65] SCOTT, *supra* note 31, § 170.6.

[66] Bogert rejected the idea that these transactions are exempt from the no further inquiry rule, stating "[t]he rule against self-dealing extends to transactions with a firm of which the trustee is a member, a corporation in which he has a controlling or substantial interest, and with a spouse, agents, employees and other persons whose interests are closely identified with those of the trustee." BOGERT, *supra* note 6, § 95.

entities. Second, the rule greatly increases beneficiaries' monitoring costs; it creates a disincentive for trustees to disclose the details of the transaction to the beneficiaries before the fact because failure to do so does not constitute a breach of duty. As a result, beneficiaries must ferret out all self-dealing.

Moreover, the UTC rule increases beneficiaries' litigation burden, and in so doing weakens the law's role as a deterrent to self-dealing. Instead of limiting beneficiaries' burden to determining whether the trustee is transacting with affiliates, the rule requires beneficiaries to evaluate the transaction in question to determine whether a court will find the transaction was affected by a conflict of interest. This means the beneficiary must understand and evaluate alternative choices the trustee might have made and determine whether a court will likely find that the transaction was "fair," a dubious enterprise which the no further inquiry rule eliminated. Moreover, because the trustee will not face liability as long as the transaction was fair, the UTC rule eliminates an important incentive the no further inquiry rule created: the incentive to advocate zealously for the trust. After all, why should the trustee expend additional effort to get the best deal for the trust if the trustee will not be held liable for settling for a transaction that is simply fair and that also generates benefits for the trustee's affiliates? Finally, the exception for professional trustees is not required on grounds of fairness. Surely professionals should know the law requiring them to obtain approval before transacting with related businesses.

Because institutional trustees increasingly are merged with or related to other types of banking and investment institutions,[67] almost all of the self-dealing in which they would be tempted to engage involves an affiliate. For institutional trustees, then, the exception set forth in section 802(c)(4) swallows the no further inquiry rule whole, creating significant costs for beneficiaries. No compelling reason exists for displacing the no further inquiry rule's thoughtful incentive structure with a rebuttable presumption.

b. Statutes That Authorize Trustees to Invest in Proprietary Mutual Funds

In the past fifteen years, the vast majority of states have enacted statutes providing that a trustee's investment in proprietary mutual funds is not a breach of the duty of loyalty,[68] even though the trustee's

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[67] *See* Leslie, *No Further Inquiry Rule*, *supra* note 16, at 573-74.

[68] *See, e.g.*, ALASKA STAT. § 13.90.010 (2005); ARK. CODE ANN. § 28-71-104 (2004); CAL. PROB. CODE § 16015 (West 2006); GA. CODE ANN. § 53-8-2 (1997); HAW. REV. STAT. § 412:8-

related or parent company collects commissions and fees in its capacity as an investment bank. It is important to emphasize that, unlike section 802(c) of the UTC, which creates a rebuttable presumption of breach, these statutes create no presumption at all. As long as the investment is consistent with the prudent investor rule, the trustee has not breached a duty.

These statutes do not compensate for information asymmetries in the negotiation process. They completely reverse the centuries-old common law rule, and require a settlor to bargain for the protection the duty of loyalty formerly provided. If the settlor's lawyer fails to inform the settlor of this issue out of a desire to obtain repeat business from the trust company, the settlor probably will not understand that the trust agreement creates an incentive for the trustee to invest in its own investments instead of others that might better serve the trust.

In addition, these statutes dramatically increase beneficiaries' monitoring costs. They remove all incentive for the trustee to make full disclosure to the beneficiary prior to transacting. They require the beneficiary to determine whether the proprietary mutual funds managed by the trustee, or the trustee's affiliate, are sufficiently inferior to other funds to constitute proof that "the trustee . . . place[d] its own interests ahead of those of the beneficiaries." If the investment does seem substandard, the beneficiary's litigation burdens will be greater: instead of disposing of the liability issue on summary judgment, as the no further inquiry rule would, the new statutes will require a trial to determine whether the trustee breached its duty.

Finally, statutes permitting trustees to invest trust assets in their own mutual funds fail to create the maximum incentives for trustees to work zealously to advance the trust's best interests. A trustee need no longer subordinate its interests to those of the trust. Instead, it can profit from its position as trustee as long as the conflicted investment is "good enough."

A few state statutes take monitoring problems more seriously, and require the trustee to obtain beneficiaries' consent to such activity in writing,[69] or, best of all, force trustees to choose between earning trustee commissions or mutual fund commissions.[70] Many statutes mitigate

400 (2004); IDAHO CODE ANN. § 68-404A (2004); 760 ILL. COMP. STAT. § 5/5.2 (2004); IND. CODE § 28-1-12-3 (1998); IOWA CODE 633.123A (2004); KY. REV. STAT. ANN. § 386.020 (West 2006); MD. CODE ANN., EST. & TRUSTS § 15-106 (West 2006); MICH. COMP. LAWS ANN. § 487.14405 (West 2006); MO. REV. STAT. § 362.550 (2000); OR. REV. STAT. § 709.175 (2003); S.C. CODE ANN. § 62-7-302 (2005); TENN. CODE ANN. § 35-3-117 (2001); UTAH CODE ANN. § 75-7-402 (1993); WASH. REV. CODE § 11.100.035 (2004); W. VA. CODE ANN. § 44-6-9 (LexisNexis 2004); WIS. STAT. § 881.01 (2003-2004).

69 NEB. REV. STAT. § 30-3205 (2005).

70 ME. REV. STAT. ANN. tit.18-A, § 7-408 (1997); N.Y. EST. POWERS & TRUSTS LAW § 11-2.2 (McKinney 1994); OKLA. STAT. ANN. tit. 60, § 175.55 (West 1997).

monitoring problems slightly by requiring the trustee to provide a statement explaining how its commissions were calculated. The UTC, in section 802(f), adopts the approach of these states.

These statutes, however, do not go far enough. A far better approach would be to require trustees to obtain settlor or beneficiary approval in writing, and to impose on trustees the burden to prove that they made full disclosure. This would telegraph to the settlor or beneficiary the need to renegotiate trustee commissions.

In sum, these statutes discourage disclosure, increase monitoring costs, and fail to encourage professional trustees to get the best deal for the trust. It is difficult to attribute this sea change in the law to anything other than effective lobbying by banks.

B. *Delegation Rules*

1. Different Rules for Different Trustees

Another area of trust law that has been reversed in recent years is non-delegation doctrine. Prior to the mid 1990s, black letter law prohibited a trustee from delegating any function the trustee could "reasonably be required personally to perform."[71] If the trustee properly delegated to an agent who thereafter damaged the trust, the trustee was liable only if it had been negligent in choosing and supervising the agent. If the trustee made an improper delegation, however, it was liable for all damage caused to the trust by the agent.

Historically, courts viewed the trustee's investment function as an act that the trustee was "reasonably . . . required personally to perform." Thus, trustees that delegated that function were held personally liable when the investment agent caused losses to the trust. Over time, as investing increased in complexity, academics and practitioners alike argued that the prohibition on delegation of the investment function should be reversed. Allowing trustees to delegate investment decisions, they argued, would better serve beneficiaries' interests by ensuring that trust assets were invested in accordance with professional standards. Reversing the doctrine also would assist the settlor who preferred to appoint a family member as trustee but was hesitant to do so because of that individual's lack of investing expertise.[72] Finally, some argue that

[71] RESTATEMENT (SECOND) OF TRUSTS § 171 (1959).

[72] John H. Langbein, *Reversing the Nondelegation Rule of Trust-Investment Law*, 59 MO. L. REV. 105, 106, 110 (1994) [hereinafter Langbein, *Reversing the Nondelegation Rule*]; UNIF. PRUDENT INVESTOR ACT § 9 cmt. (1994); John H. Langbein, *The Uniform Prudent Investor Act*

the non-delegation rule hurts only those beneficiaries serviced by non-professional trustees with no investment experience because, unlike their professional counterparts, these trustees would not be savvy enough to draft around the rule.[73]

Undoubtedly, a rule flatly prohibiting all trustees from delegating investment functions is unwise. Yet reversing the non-delegation rule raises another set of questions. First, what limits, if any, should be placed on a trustee's power to delegate? Second, how does a trustee's delegation of the investment function affect its fiduciary duties to trust beneficiaries? Third, should the trustee's agents owe fiduciary duties directly to the trust beneficiaries? I argue in the following section that the answers to these questions should depend on whether the trustee is a professional or a non-professional.

a. Delegation and the Professional Trustee

This Article has established that background rules for professional trustees should create strong incentives to 1) provide full information to settlors during the trust creation process and craft any modifications of fiduciary rules narrowly and specifically, 2) provide full and fair disclosure to beneficiaries prior to deviating from the settlor's reasonable expectations, and 3) perform to the highest level of professional standards consistent with the settlor's intent. A rule that allows professional trustees to delegate the investment function should reflect those objectives.

When a professional trustee properly delegates, what implications should that have with respect to the trustee's continued liability to the beneficiaries? There are three options: 1) a rule that relieves the trustee from all liability if the agent harms the trust, 2) a rule that holds the trustee liable only if its failure to carefully select and supervise the agent contributes to the trust's losses, or 3) a rule that makes the trustee liable for losses caused by its agent. The first option is unwise for obvious reasons. In the following paragraphs, I argue that professional trustees should be held liable for the acts of their investment agents, regardless of whether the trustee is negligent in choosing or supervising that agent. This background rule would best effectuate the settlor's intentions and address the problems inherent in the professional trustee context.

First, a strict liability rule is probably the rule the settlor would have agreed to if he had thought about the issue during the drafting process. The settlor chose the trustee largely because of its expertise in

and the Future of Trust Investing, 81 IOWA L. REV. 641, 650 (1996).

[73] Langbein, *Reversing the Nondelegation Rule*, *supra* note 72, at 109-10.

trust management. Presumably, then, the settlor would expect the trustee to delegate the investment function only in rare instances.[74] A strict liability rule pressures trustees to delegate only when doing so would make the beneficiaries better off, but does not inhibit necessary delegation—if the trustee knows it lacks the skills to handle particular investment duties, delegating will be a superior choice to not delegating, even if the trustee will face liability for the agent's acts. The rule creates incentives to use maximum care in selecting and monitoring an agent, and protects the beneficiaries from being harmed through no fault of their own. By contrast, a rule holding the trustee liable only for negligent supervision may unnecessarily encourage delegation—the trustee will actually have less exposure to liability if it delegates than if it does not. Although reasonable limits on the power to delegate might mitigate this problem, if courts review decisions to delegate under an abuse of discretion standard, the incentive to delegate will still exist.[75]

Second, a strict liability rule would best force trustees who intend to delegate to negotiate with the settlor for permission, and to craft the terms of trustee liability.[76] This process would highlight issues such as how delegation of the investment function should affect the trustee's compensation, providing clearer guidance for both the trustee and the beneficiaries in the years to come. Trustees who later raise a trust provision releasing them from liability for the agent's acts would have the burden to show that the settlor possessed full information about the meaning and existence of the clause. This could be easily accomplished if the trust provides for a reduced trustee commission in the event of delegation.

Third, when a trust document fails to authorize the trustee to delegate the investment function, a rule holding the trustee liable for the acts of its agent would encourage trustees to seek permission in advance from trust beneficiaries, reducing beneficiaries' monitoring costs. This prior disclosure would also highlight for the beneficiaries the need to discuss how delegation will affect trustee compensation.

By contrast, a rule holding the trustee liable only if it is negligent in choosing or monitoring its agents exacerbates the information and monitoring problems that exist in the professional trustee context. The rule creates no incentive to bring the delegation issue to the settlor's attention during the negotiation process, nor to seek beneficiary

74 RESTATEMENT (THIRD) OF TRUSTS § 227 cmt. j (1992).

75 Comments to the Third Restatement draft read that the trustee is not expected to personally perform the investment decision-making function "even if the trustee is a professional or institutional fiduciary with competence and experience in financial matters." RESTATEMENT (THIRD) OF TRUSTS § 90 cmt. f(1) (Tentative Draft No. 4, 2005).

76 Many professional trustees already routinely engage in this practice. *See* Langbein, *Reversing the Nondelegation Rule*, *supra* note 72, at 109-10, 118.

approval prior to delegating. The rule leaves it up to the beneficiary to determine when the trustee has delegated its investment function, and to take the initiative in getting the trustee to adjust its commission structure if the trustee fails to do so. Moreover, because the beneficiary will bear the risk of loss if the agent harms the trust, this rule places additional unjustified burdens on the beneficiary, not only to monitor the trustee, but also to monitor the agent.

Although the "negligence" rule creates some incentive to monitor, it does little to protect the beneficiary if the agent commits a spectacular one-shot breach, such as appropriating trust funds or committing other acts of self-dealing.[77] Routine monitoring cannot anticipate and prevent one-shot breaches. Making the trustee personally liable for such breaches will not generally harm the trustee, because trustees can continue to draft around the rule,[78] and because if they fail to do so, they have a claim against the breaching agent, assuming that agent is solvent. So the question boils down to this: who should bear the cost of an agent's breach (both litigation costs and the harm to the trust) if the agent is judgment-proof? The trustee, who chose the agent and can spread the loss, or the beneficiary, who had nothing to do with the decision but would bear the full loss by itself? Common sense says that most settlors would prefer a default rule that imposes liability on the trustee. In choosing a professional trustee, the settlor is foregoing the advantage of personal trust administration in favor of the superior investment and management skills of a professional trustee. It is unlikely that they would expect the beneficiaries to bear the loss in the event that the trustee decides to delegate responsibility to a judgment-proof agent.

b. Delegation and the Non-Professional Trustee

On the other hand, imposing strict liability on the non-professional trustee when an agent harms the trust is probably not the default rule most settlors would prefer. When the settlor chooses a family member or friend whom the settlor knows is inexperienced with investing, it is reasonable to believe that the settlor expected and would want the trustee to delegate the investment function to a more qualified person or entity. In fact, unless the settlor has appointed a professional co-trustee, the settlor probably expects that the trustee will delegate the investment function to some degree, even if only by investing in mutual funds. Delegation allows the beneficiary to benefit from personal trust

[77] EASTERBROOK & FISCHEL, *supra* note 2, at 103.
[78] *Id.*

administration without having to sacrifice the quality of the investment decisions required to protect and grow trust assets. Not imposing liability on a non-professional who delegates to an investment agent is consistent with the spirit of the old non-delegation rule. The trustee could always delegate tasks that the settlor did not intend for him to perform personally, and when the delegation is proper, the trustee would not be liable for acts of an agent reasonably selected and supervised.[79] The modern settlor no more expects a non-professional trustee to be an investment professional than she expects him to provide legal services, a delegation that has always been proper.[80] Finally, because the non-professional cannot spread the risk of loss, there is less reason to think that the settlor would want to the trustee rather than the trust to absorb the loss.

Moreover, because trustee's agent will possess a higher level of expertise than the trustee, the trustee's abilities to evaluate and monitor the agent are limited. Most settlors would probably want to impose liability only if the trustee is negligent in choosing or supervising the agent. And when the non-professional trustee takes no commission, beneficiaries will not be harmed if the trustee's agent charges fees.

2. Common Law, Common Sense

Although conventional wisdom holds that the common law non-delegation rule was flat wrong, in this Article, I take the controversial position that the common law was not as far from the mark as it first appears. First, although the prohibition against delegating the investment function ostensibly applied to all trustees, courts rarely found non-professionals liable for improper delegation if the trustee used due care in monitoring the agent. Second, the common law rule holding professional trustees liable for the acts of an investment agent was correct, but for the wrong reasons.

First, courts often accounted for the status of the trustee in determining when to impose liability for improper delegation. Prior to the changes in the non-delegation rule, courts did not routinely impose liability when a non-professional trustee violated the non-delegation doctrine by delegating categorically discretionary functions. For example, in 1943, long before the trend towards permissive delegation began, the Supreme Court of Pennsylvania refused to surcharge an executor who signed an agency agreement with a bank that allowed the bank to suggest suitable investments without assuming responsibility

79 RESTATEMENT (SECOND) OF TRUSTS §§ 171, 225 (1959).
80 Langbein, *Reversing the Nondelegation Rule*, *supra* note 72, at 108.

for the outcome of the recommendations. The record showed that the executor did in fact delegate more than just ministerial tasks. The court, however, emphasizing the executor's diligent review of the bank's actions, and approval of transactions, refused to surcharge the executor for breach.[81]

On the other hand, courts imposed liability on non-professional trustees when the trustee blatantly failed to supervise the activities of the agent and the trustee's prolonged negligence exacerbated the trust's losses. For example, in *Shriners Hospital for Crippled Children v. Gardiner*, a case often cited for the proposition that delegation of investment authority is improper, the trustee simply turned over all investment decisions to an embezzling stockbroker. Although the court cited the non-delegation rule as justification for its decision, the court also emphasized that the trustee provided absolutely no supervision and took no care to monitor or review the acts of the agent.[82] In short, the case law does not reveal heavy-handed imposition of strict liability against non-professional trustees who delegated and diligently monitored in good faith. Instead, the case law appears to be reasonably consistent with the current delegation rule.

Second, cases imposing liability on professional trustees for the acts of their investment agents reach the correct result, for perhaps the wrong reasons. Although a rule permitting appropriate delegation is certainly the better approach, at least today, it does not follow that the trustee's fiduciary duties should be reduced simply by the unilateral decision to delegate. The end result of the old rule, which is that trustees were liable for breaches of duty by the investment agent, is sound.

3. Statutory Shortcomings

[81] *In re* Kohler's Estate, 33 A.2d 920 (Pa. 1943); *see also In re* Quinlan's Estate, 273 A.2d 340 (Pa. 1971) (finding non-professional executor who improperly delegated to bank the power to negotiate sale of trust-owned business should not be removed as trustee because he acted in good faith and on advice of counsel).

[82] Shriners Hosps. For Crippled Children v. Gardiner, 733 P.2d 1110 (Ariz. 1987); *see also* Gaines v. Dahlin, 154 So. 101 (Ala. 1934) (voiding agreement between trustee and bank because it conferred absolute discretion on bank to invest, and prohibited trustee from interfering for ten years); *In re* Will of Hartzell, 192 N.E.2d 697 (Ind. Ct. App. 1963) (finding trustee in breach for allowing embezzling attorney to hold funds from sale of trust property without inquiry and without ever requiring an accounting); *In re* Will of Jones, 765 N.Y.S.2d 756 (Sur. Ct. 2003) (declining to approve power of attorney by trustee to co-trustee, since it would result in delegation without supervision); Abrams v. U.S. Fid. & Guarantee Co., 106 N.W. 1091 (Wis. 1906) (holding guardian liable for losses for failing to supervise embezzling attorney who collected, retained, and invested insurance proceeds for orphaned children).

Both the Uniform Prudent Investor Act and the UTC provide that 1) trustees' delegation authority varies depending on the identity of the trustee and the purpose of the trust and 2) the trustee's agent owes fiduciary duties to the trust, but that 3) if the trustee's agent causes the trust harm, the trustee is personally liable only if the trustee acted negligently in selecting, directing, or monitoring the agent.[83] The drafters appropriately considered the differences between professional and non-professional trustees in terms of the scope of permissible delegation. Yet the rule's liability provisions could have been better crafted to account for this difference. The provisions concerning the trustee's liability to the trust for the agent's acts are best suited to the case of the non-professional trustee. As applied to professional trustees, however, the statute could create a better incentive structure.

In explaining the decision to hold trustees liable for their agents' acts only on a showing that the trustee was negligent, the drafters acknowledge that there is "an intrinsic tension" between "granting trustees broad powers that facilitate flexible and efficient trust administration, on the one hand, and protecting trust beneficiaries from the misuse of such powers on the other hand."[84] Ultimately, however, they determine that imposing on the trustee duties of "care, skill and caution" in delegating, and imposing fiduciary duties directly on the agent, provides sufficient protection for the beneficiary.[85] Nowhere do

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[83] UNIF. PRUDENT INVESTOR ACT § 9 (1994) provides:

> (a) A trustee may delegate investment and management functions that a prudent trustee of comparable skills could properly delegate under the circumstances. The trustee shall exercise reasonable care, skill, and caution in:
>
> (1) selecting an agent;
>
> (2) establishing the scope and terms of the delegation, consistent with the purposes and terms of the trust; and
>
> (3) periodically reviewing the agent's actions in order to monitor the agent's performance and compliance with the terms of the delegation.
>
> (b) In performing a delegated function, an agent owes a duty to the trust to exercise reasonable care to comply with the terms of the delegation.
>
> (c) A trustee who complies with the requirements of subsection (a) is not liable to the beneficiaries or to the trust for the decisions or actions of the agent to whom the function was delegated.

[84] *Id.* at § 9 cmt.

[85] The comment to section 9 of the Uniform Prudent Investor Act states:

> There is an intrinsic tension in trust law between granting trustees broad powers that facilitate flexible and efficient trust administration, on the one hand, and protecting trust beneficiaries from the misuse of such powers on the other hand. . . . If the trustee delegates effectively, the beneficiaries obtain the advantage of the agent's specialized investment skills or whatever other attributes induced the trustee to delegate. But if the trustee delegates to a knave or an incompetent, the delegation can work harm upon the beneficiaries.
>
> Section 9 of the Uniform Prudent Investor Act is designed to strike the appropriate balance between the advantages and the hazards of delegation. . . . Section 9(a) imposes duties of care, skill, and caution on the trustee in selecting the agent, in

they make the case that the beneficiary, rather than the trustee, should bear the risk of loss of an insolvent agent.

The drafters also recognize that allowing broad delegation powers may create costs for the beneficiaries. As they state,

> the trustee must be alert to protect the beneficiary from "double dipping." If, for example, the trustee's regular compensation schedule presupposes that the trustee will conduct the investment management function, it should ordinarily follow that the trustee will lower its fee when delegating the investment function to an outside manager.

Thus, they opt for a rule that places all of the monitoring costs on the beneficiaries, and that leaves decisions about the trustee's proper compensation to the integrity of the trustee.

III. MODIFYING FIDUCIARY RULES

A. *Different Standards for Different Trustees*

We have seen that the identity of the trustee is an important factor in determining how courts apply fiduciary standards. It also plays an important role when courts confront various conflicts arising from a second issue: to what extent are fiduciary standards modifiable by the parties to the trust document? In recent years it has become fashionable to describe fiduciary standards as "default rules" around which the parties can freely draft. However, to equate fiduciary rules with true default rules, such as those found in the UTC, would be an error.[86] Even scholars and the drafters of the UTC who have embraced the "default rule" rhetoric admit that there are, and should be, some limits on parties' ability to waive or modify the rules.[87] To date, they have

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> establishing the terms of the delegation, and in reviewing the agent's compliance. The trustee's duties of care, skill, and caution in framing the terms of the delegation should protect the beneficiary against overbroad delegation.

Id. The comment also states:

> Although subsection (c) of the Act exonerates the trustee from personal responsibility for the agent's conduct when the delegation satisfies the standards of subsection 9(a), subsection 9(b) makes the agent responsible to the trust. The beneficiaries of the trust can, therefore, rely upon the trustee to enforce the terms of the delegation.

Id.

86 *See generally* Leslie, *Trusting Trustees*, *supra* note 2.

87 *See, e.g.*, John H. Langbein, *Mandatory Rules in the Law of Trusts*, 98 NW. U. L. REV. 1105, 1111-17; 1121-25 (2004). Langbein acknowledges the need for a narrow mandatory regime to deal with potential trustee fraud, *id.* at 1124-25, and suggests that policies against perpetuating inefficient dead-hand control might justify a court's refusal to enforce a settlor's directive to concentrate trust investments in only one asset (a waiver of the duty to diversify). *Id.* at 1111-17. He also suggests that concern for effectuation of settlors' intent justifies Uniform

offered no theoretical justification for limiting fiduciary duties at all. In a recent article, I have offered a theoretical framework for determining whether and to what extent particular fiduciary rules can be modified.[88] In the following paragraphs, I draw on that theory to explore how the identity of the trustee should be a factor in evaluating the extent to which fiduciary rules can be modified.

I argue in the following paragraphs that the asymmetrical information problem and concerns for settlors' intent justify treating the modification issue differently depending on the trustee's identity. I conclude that there is little justification for allowing professional trustees to hide behind broad protective waivers, but that such waivers are more justifiable when the trustee is a non-professional, and that the majority of courts understand this. Transaction-specific waivers are less problematic, although courts rightly construe them more strictly against professional trustees. Finally, I submit that certain statutory developments over the last twenty years create default rules for institutional trustees that lack the wisdom of the common law and create risks for all beneficiaries.

1. Professional Trustees

Parties' attempts to modify fiduciary standards can take various forms. Some trust provisions are broadly worded attempts to decrease fiduciary standards. An example would be a provision that exculpates the trustee from liability for loss stemming from the trustee's acts, except for acts taken in bad faith or with reckless disregard for the beneficiaries' interests (hereinafter, I will call these types of non-specific waivers "broad waivers"). Other modifications are carefully limited and transaction-specific; for example, a settlor may transfer into trust shares of stock in a corporation in which the trustee has an interest and relieve the trustee from the no further inquiry rule with respect to those investments. Or, the settlor may have an undiversified portfolio consisting of stock in the settlor's closely owned family business and may absolve the trustee from liability for failing to diversify, or from liability for loss in value of the stock (hereinafter, "transaction-specific waivers").

As we have seen, when the settlor engages a professional trustee, the negotiation process is often characterized by stark information asymmetries. Because a trust provision reducing fiduciary duties or

Trust Code provisions that do not allow a settlor to waive trustee's duty to act in good faith, or to waive all of the trustee's fiduciary duties. *Id.* at 1121-25.

[88] Leslie, *Trusting Trustees*, *supra* note 2.

exculpating the trustee is inconsistent with the premise of the relationship, settlors who are not well counseled are unlikely to spot it, or if they spot it, to understand its likely effect.

In determining what the limits on a professional trustee's ability to modify fiduciary protections should be, one thing is clear: there are few, if any, good reasons for a settlor to agree to a broad exculpatory clause that dramatically raises a professional trustee's threshold of liability. The essence of the transaction is the settlor's desire to retain an expert level of service for his beneficiaries. Nor would a settlor have much reason to authorize the trustee to profit from its position without advance approval. Generally, then, broad waivers are inconsistent with settlors' desire to retain professional management. Often, the very existence of a broad exculpatory clause in a trust document may be evidence that the parties had unequal access to information during the negotiation process.[89]

When a professional trustee insists on a broad waiver, a fully informed settlor might have three possible motivations for agreeing.[90] For the first two, a broad waiver is a sub-optimal solution, a fact that the settlor's attorney would presumably explain. First, believing that a particular beneficiary is unstable or unduly litigious might lead a settlor to reduce that beneficiary's incentive to litigate by absolving the trustee of liability for negligent management. Reducing the level of care that the trustee owes to *all* beneficiaries is a less appealing solution than carefully limiting the trustee's discretion to make distributions to that beneficiary, or alternatively, including a carefully drafted clause imposing consequences for frivolous litigation on particular beneficiaries. Second, a trustee might insist on a limitation on trustee liability as a condition to taking on certain investments, an insufficiently diversified portfolio, or investments in which the trustee has an interest. Here again, a transaction-specific modification authorizing the investments and protecting the trustee from liability only for losses stemming from those specific investments is the best solution.

Third, a settlor might (conceivably) agree to a reduced standard of care, or authorize the fiduciary to profit from its position, because a professional trustee insists upon it. An informed settlor presumably would seek something in exchange, such as lower trustee fees. In these presumably rare instances, enforcement of a broad waiver would be proper only if the trustee presented clear evidence that the settlor had full information concerning the meaning and likely effect of the clause.[91] The best evidence, of course, would be evidence that the

[89] *Id.* at 100-04.

[90] For a fuller analysis of this topic, see *id.* at 101-04.

[91] *Id.*

trustee offered the settlor two prices for two different services: one commission for full-service trusteeship, and a lower commission for an agreement that includes an exculpatory clause lowering the standard of care or authorizing trustee self-dealing.[92] Placing the burden on the trustee would create a disincentive for reflexive use of broad waivers, would force disclosure during bargaining when the trustee believes that a clause is necessary, and would induce the settlor to obtain independent advice about the meaning of the clause.

On the other hand, transaction-specific waivers, such as a clause that authorizes the trustee to hold a particular investment in trust, and exculpates the trustee for loss if that investment loses value, are more likely than broad waivers to be the product of negotiation. Because these narrow clauses raise less concern about information problems, courts should be more willing to enforce them.

Thus, the optimal rule for professional trustees will force full disclosure during the negotiation process.[93] Absent clear and convincing evidence of full disclosure, broad waivers of entire duties (such as the duty of care) almost never should be enforced.

Note that this rule is not necessary to protect the majority of settlors, who will have attorneys who bargain strenuously to protect them. Very high net worth individuals, who often have attorneys who look out for their interests generally, and other settlors who have capable counsel will not need the benefit of this approach because counsel will insist that they agree to a broad waiver only in the rare circumstances where such a clause advances their best interests. The rule is necessary for those who are either unrepresented or inadequately represented.

2. Non-Professional Trustees

The asymmetrical information problem is less likely to exist when the settlor chooses as trustee a non-professional associate or family member. In this situation, the settlor chooses the trustee because the trustee has a relationship with the settlor and the objects of the settlor's bounty, and can be trusted to make discretionary decisions about the beneficiaries' respective needs. Individual trustees of this sort are unlikely to be trustees of other trusts, are less likely to participate in drafting the trust's terms, and are likely to be on a level playing field

92 *See* Coffee, *supra* note 5, at 1623 (stating that "courts should uphold opt-out provisions that deviate from traditional fiduciary standards only when they can find that the term has been accurately priced"); *see also id.* at 1666-68 (discussing difficulties with accurate pricing).

93 *See* Sitkoff, *supra* note 15.

with the settlor in terms of sophistication. When the settlor chooses a non-professional trustee, therefore, information problems are unlikely to be significant.

When a broad waiver is contained in a trust document that names a non-professional trustee, it should be less cause for concern. There are good reasons for settlors to immunize non-professionals from liability for actions taken in good faith. When the settlor chooses the trustee because he trusts her to provide the best care for family members and make responsible distribution choices, that trust, and not an expectation of expert investment skills, may be the essence of the relationship. The settlor may wish to immunize her for good faith mistakes, especially when she is not getting compensated. Reducing the liability standard may also be necessary to induce a non-professional to perform the role.

Because information asymmetries are unlikely to be a significant problem in most cases, even broad waivers should be enforced. Given that information problems are less serious and the need for exculpation is greater, it is important to give settlors and their non-professional trustees more leeway to draft around fiduciary rules in order to effectuate the settlor's purpose. Courts interpreting waivers in these trusts should approach the issue as though they were interpreting a contract.

B. *Common Law, Common Sense*

Conventional wisdom holds that courts generally enforce exculpatory clauses in trust documents regardless of the trustee's identity.[94] Although courts occasionally do seem to reflexively honor these clauses,[95] the vast majority of courts do not take such a cavalier approach when a professional trustee attempts to avoid liability by invoking a broad waiver. For starters, a few state courts have flatly refused to uphold broad exculpatory clauses to protect professional trustees from liability when they have acted negligently.[96] Some judges

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[94] *See* RESTATEMENT (SECOND) OF TRUSTS § 222, reporter's notes (1959).

[95] *See, e.g.*, Warren v. Pazolt, 89 N.E. 381 (Mass. 1909).

[96] New Jersey courts have determined that, as a general matter, an exculpatory clause cannot relieve a trustee from liability "where a loss results from negligence in the administration of a trust." Behrman v. Egan, 95 A.2d 599, 601 (N.J. Super. Ch. Div. 1953) (citing Liberty Title & Trust Co. v. Plews, 60 A.2d 630 (N.J. Ch. 1948)); *see* Dickerson v. Camden Trust Co., 53 A.2d 225 (N.J. Ch. 1947), *aff'd*, 64 A.2d 214 (N.J. 1949); *see also* Semler v. Corestates Bank, 693 A.2d 1198 (N.J. Super. Ct. App. Div. 1997) (holding the trustee liable for negligence on the ground that the trustee's negligent acts fell outside the scope of protection the exculpatory clause provided). The Alabama Supreme Court has held that "although a trustee's duties and obligations are governed largely by the trust agreement, that agreement cannot be employed to vitiate 'the duty imposed by the 'prudent person' standard.'" First Ala. Bank of Huntsville, N.A. v. Spragins,

have taken more extreme action: in the 1930s, New York Surrogates drafted and advocated for a statute,[97] still on the books, that codified the Surrogates' view that exculpatory clauses in testamentary trusts violate public policy.[98] Legislative history suggests the Surrogates believed that professional trust companies were routinely including boilerplate exculpatory clauses in trust instruments, that settlors did not understand the meaning of the provisions,[99] and that settlors' attorneys failed to protect their clients' interests in an effort to obtain repeat business from the trust companies.[100] Other courts, while not going so far as to

515 So. 2d 962, 964 (Ala. 1987) (holding that a trust provision cannot alter the trustee's duty to use reasonable care in making and managing investments).

[97] According to a letter written by Surrogate Wingate to Governor Lehman, the bill was drafted by Surrogates Wingate, Foley, and Delehanty. The Surrogate's Association of New York State approved the bill. Letter from Surrogate George Albert Wingate to Governor Herbert H. Lehman (Apr. 1, 1936) (on file with The Association of the Bar of the City of New York library).

[98] N.Y. EST. POWERS & TRUSTS LAW § 11-1.7 (McKinney 1967). That section provides: "(a) The attempted grant to an executor or testamentary trustee, or the successor of either, of any of the following enumerated powers or immunities is contrary to public policy: (1) The exoneration of such fiduciary from liability for failure to exercise reasonable care, diligence and prudence." *Id.*

[99] Surrogate Wingate argued that:

> the chief vice [with exculpatory clauses] arises from the fact that the average testator neither sees nor understands these clauses nor the effect that they may produce among his dependents. He is primarily concerned with the fact that certain dependents are to receive, as he believes, certain portions of his property, and is content to leave to the attorney drawing the will the administrative portions thereof.

Letter from Surrogate George Albert Wingate to Governor Herbert H. Lehman, *supra* note 96. In another letter, Surrogate Wingate argued that the testator in the vast majority of cases had not "any remote realization of the fact that he was subjecting the property upon which his dependents must look for support, to potentially serious jeopardy." Letter from Surrogate George Albert Wingate to Governor Herbert H. Lehman (Apr. 21, 1936) (on file with the Association of the Bar of the City of New York library); *see also* REP. No. 6.11A, Leg. Doc. (1965) No. 19, pp. 499-501 (quoting legislative history establishing that the purpose of the statute was "to protect testators and the objects of their bounty from the untoward effects of ingeniously contrived clauses, the full legal consequences of which are seldom appreciated at the time of the execution of the wills containing them").

[100] As one Surrogate put it:

> the drawing of wills . . . has to perhaps a preponderant extent fallen into the hands of lawyers who are either actively engaged in work for these financial institutions or hopefully anticipate such retainers. As a result, men who are more and more coming to do the work of testamentary draftsmanship, have come to view the wills they are called upon to draw from the standpoint of the corporate fiduciaries whom they expect to represent, rather than from that of the testator and the persons, whether dependents or otherwise, whom he desires to benefit.

Letter from Surrogate George Albert Wingate to Governor Herbert H. Lehman, *supra* note 98. Surrogate Wingate further argued that

> these corporate fiduciaries in too many instances view the entire matter [of drafting a will with a testamentary trust provision] not so much as a sacred trust upon which the welfare of the beneficiaries, and indeed, at times, their very existence depends, as just another piece of business to be handled in a routine way, frequently by underpaid clerks, lacking both experience and sound judgment.

Id.

expressly prohibit broad waivers, construe them very narrowly against professional trustees, imposing liability on the ground that the trustee's conduct falls outside the scope of the clause's protection.[101] When creative trustees have argued that broad waivers relieving them of liability for acts taken in good faith permit them to self-deal, courts have rejected the argument.

Moreover, the cases most often cited to support the proposition that exculpatory clauses are enforceable do not, when read carefully, support that generalization. In fact, a more accurate reading of the case law is that courts "uphold" exculpatory clauses and shield trustees from liability if the case falls into at least one of the following categories:

> 1) the trustee was not in fact negligent at all;[102]
>
> 2) the "trust" is not a prototypical private express trust, but part of an arm's length business arrangement;[103]
>
> 3) the modification was a carefully drawn, transaction-specific modification of the trustee's fiduciary duty and the conduct complained of fell squarely within the clause's protection;[104]

[101] *See* McNeil v. McNeil, 798 A.2d 503, 509 (Del. 2002) (considering a trust provision that protected trustee from liability for negligence, and concluding that trustee was liable for breach of trust because "[a] reasonable construction of these provisions . . . is that the Lois Trustees were exculpated for ordinary negligence, but not the duty to (i) inform beneficiaries or (ii) treat them impartially"); *In re* Williams' Trust, 591 N.W.2d 743 (Minn. Ct. App. 1999) (upholding validity of exculpatory clause shielding trustees from liability from errors in judgment, but finding that trustee's failure to sell declining stock for over four years, even though stock comprised majority of trust's assets, could constitute a breach of fiduciary duty because failure was not "an error in judgment" but might amount to "negligence"); *Behrman*, 95 A.2d 599 at 601 (citing *Liberty Title & Trust*, 60 A.2d 630); Villard v. Villard, 219 N.Y. 482 (1916) (holding that clause purporting to shield trustee from liability for retaining investments originally held by settlor did not shield him from liability for failing to sell investments that it did not know were not part of settlor's estate); Bauer v. Barernschmidt, 187 A.D.2d 477 (N.Y. App. Div. 1992) (holding that exculpatory clause did not protect trustee from liability for making certain negligent expenditures); *In re* Rushmore's Estate, 21 N.Y.S.2d 526 (Sur. Ct. 1940) (holding that an exculpatory clause directing that trustee would not be held liable "for any act done . . . in good faith hereunder" did not shield trustee from liability for "non-legal" investments); Jewett v. Capital Nat'l Bank of Austin, 618 S.W.2d 109 (Tex. App. 1981) (holding that an exculpatory clause relieving trustee of liability for investing in speculative stocks did not shield the trustee from liability for negligence in failing to diversify the trust's assets).

[102] *See, e.g.*, Kimball v. New England Trust Co., 14 Conn. Supp. 432 (Super. Ct. 1947); Powell v. Cocowitch, 94 So. 2d 589, 591-92 (Fla. 1957); *In re* Nuese's Estate, 96 A.2d 298 (N.J. 1953); Blauvelt v. Citizens Trust Co., 71 A.2d 184 (N.J. 1950); *In re* Clark's Will, 177 N.E. 397 (N.Y. 1931); *In re* Cowles' Will, 255 N.Y.S.2d 160, 172-73 (App. Div. 1965); Matter of City Bank Farmers Trust Co., 61 N.Y.S.2d 484 (App. Div. 1946); Spring v. Hawkes, 41 A.2d 538 (Pa. 1945).

[103] *See, e.g.*, Gardner v. Squire, 49 N.E.2d 587 (Ohio Ct. App. 1942).

[104] *See, e.g.*, Perling v. Citizens & S. Nat'l Bank, 300 S.E.2d 649 (Ga. 1983); Bartlett v. Dumaine, 523 A.2d 1, 11 (N.H. 1986) (upholding exculpatory clause because "Dumaines 'is a unique trust, having features of both a trust and a corporation,' and . . . '[s]ince the Dumaines Trustees are to establish and carry on businesses, the settlor clearly intended that the 'prudent [person] rule' of investment would not be applicable'"); Farr v. First Camden Nat'l Bank & Trust

4) the settlor or beneficiary gave advance approval for the trustee's acts;[105] or

5) the trustee was a non-professional.[106]

In short, most courts intuitively understand the asymmetrical information problem, and allow professional trustees to hide behind exculpatory clauses only if there is evidence that the settlor had full information, the trustee obtained advance approval, or the trustee is a non-professional. But understanding courts' approach requires a careful reading of the case law and a willingness to disregard blanket statements found in treatises. Because the message of the case law may be murky, a clearly drafted statute could go a long way in clarifying the rule. This would create additional incentives for professional trustees to make full disclosure about any exculpatory provisions they wish to insert in the trust documents.

Similarly, another creature of the common law works to ensure that professional trustees make full disclosure before they act in a way that is inconsistent with fiduciary duties—the no further inquiry rule. By imposing strict liability for self-dealing without advance approval, the rule creates the strongest possible incentives to make full disclosure. Courts' approach to the duty of care and the duty of loyalty make eminent sense.

C. *Statutory Shortcomings*

The UTC sets some limits on the parties' ability to modify or eliminate fiduciary rules. Yet the relevant Code provisions, read together with the comments, fail to take sufficient account of the differences between professional and non-professional trustees.

The UTC begins by emphasizing that it is largely comprised of default rules. With respect to fiduciary duties, the Code sets limits on the parties' abilities to waive or modify fiduciary standards. Section 105(b)(2) and (3) dictate that the parties may not waive "the duty of the trustee to act in good faith and in accordance with the purposes of the trust" nor "the requirement that a trust and its terms be for the benefit of the beneficiaries."[107] Taking a cue from the Second Restatement,[108]

Co., 66 A.2d 444 (N.J. Super. Ct. App. Div. 1949); *In re* Cowles' Will, 22 A.D.2d 365, 378 (N.Y. App. Div. 1965); Hoffman v. First Va. Bank, 263 S.E.2d 402 (Va. 1980).

105 *In re* Leupp, 153 A. 842 (N.J. Ch. 1931).

106 *See* Pearson v. Barr, No. D037414, 2002 WL 1970144 (Cal. Ct. App. Aug. 27, 2002); Crabb v. Young, 92 N.Y. 56 (1883); *In re* Mallon's Estate, 89 N.Y.S. 554 (Sur. Ct. 1904); Biddulph v. Delorenzo, No. 83808, 2004 WL 1902725 (Ohio Ct. App. Aug. 26, 2004).

107 The Comments explain:

> Subsection (b)(2) provides that the terms may not eliminate a trustee's duty to act in

section 1008 of the UTC provides that an exculpatory clause relieving the trustee from liability for breach of fiduciary duty is enforceable, except to the extent it relieves the trustee of liability for acts taken in bad faith or with reckless indifference to the purposes of the trust.[109]

Thus, the Code gives the parties wide latitude to modify or eliminate trustees' fiduciary duties. For example, it is clear that the parties can relieve the trustee from liability for negligence. Taken literally, the Code also allows the parties to authorize the trustee to profit indiscriminately from its position of trust, as long as the trust profits as well. The drafters do not explain why they place any limits on the parties' ability to contract, nor do they explain why they draw the lines where they do. Perhaps they were cognizant of information

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> good faith and in accordance with the purposes of the trust. Subsection (b)(3) provides that the terms may not eliminate the requirement that a trust and its terms must be for the benefit of the beneficiaries. Subsection (b)(2)-(3) are echoed in Sections 404 (trust and its terms must be for benefit of beneficiaries), 801 (trustee must administer trust in good faith, in accordance with its terms and purposes and the interests of the beneficiaries), 814 (trustee must exercise discretionary power in good faith and in accordance with its terms and purposes and the interests of the beneficiaries), and 1008 (exculpatory term unenforceable to extent it relieves trustee of liability for breach of trust committed in bad faith or with reckless indifference to the purposes of the trust and the interests of the beneficiaries).

UNIF. TRUST CODE § 105 cmt. (2005).

108 RESTATEMENT (SECOND) OF TRUSTS § 222 (1959) (stating that although strictly construed, exculpatory provisions, absent an abuse in insertion into the trust instrument, relieve the trustee of liability for breach of trust unless the breach is committed in "bad faith, or intentionally or with reckless indifference to the interest of the beneficiary"). Yet the fact is that most states do not have a rule in place that actually results in shielding trustees from liability for gross negligence. California and states that have followed its lead have expressly rejected the Restatement formulation, prohibiting by statute exculpatory clauses that purport to relieve the trustee for liability from gross negligence. *See, e.g.*, CAL. PROB. CODE § 16461(b) (West 2003) (providing that an exculpatory clause in a trust document "is not effective to relieve the trustee of liability (1) for breach of trust committed intentionally, with gross negligence, in bad faith, or with reckless indifference to the interest of the beneficiary, or (2) for any profit that the trustee derives from a breach of trust"); MONT. CODE ANN. § 72-34-512 (2003) (same as California but omitting bad faith). The Official Comments to section 16461(b) of the California Probate Code state: "This section is the same in substance as part of Section 222 of the Restatement (Second) of Trusts (1957), except that the reference to gross negligence does not appear in the Restatement." CAL. PROB. CODE § 16461(b) cmt. (West 2003).

109 UNIF. TRUST CODE § 1008 (2005) provides:

> (a) A term of a trust relieving a trustee of liability for breach of trust is unenforceable to the extent that it:
>
> > (1) relieves the trustee of liability for breach of trust committed in bad faith or with reckless indifference to the purposes of the trust or the interests of the beneficiaries; or
> >
> > (2) was inserted as the result of an abuse by the trustee of a fiduciary or confidential relationship to the settlor.
>
> (b) An exculpatory term drafted or caused to be drafted by the trustee is invalid as an abuse of a fiduciary or confidential relationship unless the trustee proves that the exculpatory term is fair under the circumstances and that its existence and contents were adequately communicated to the settlor.

problems; it seems certain that no informed settlor would agree to trust terms that authorize reckless, bad faith behavior, or that allow the trustee to plunder the trust assets at will. If information asymmetries justify placing limits on the parties' freedom to contract, though, why prohibit only the most egregious forms of opportunistic behavior? Sufficient attention to differences between professional and non-professional trustees in the trust formation process helps determine where the lines should be drawn.

On its face, section 1008 of the UTC is a fairly sensible approach to the exculpatory clause problem for both professional and non-professional trustees. The model statute wisely takes steps to remedy information problems: in addition to placing some limits on the permissible scope of waivers,[110] it places the burden to prove that the settlor was informed of the exculpatory clause squarely on the trustee who inserts it. The trustee must prove both that the clause was "fair" and that the clause's "existence and contents were adequately communicated to the settlor." Nothing in the language requires courts to abandon their traditional approach to broad exculpatory clauses. In applying this statute, most courts would likely enforce limited, transaction-specific waivers, as well as broad waivers drafted to protect non-professionals. Professionals who seek to avoid liability by invoking broad waivers would have the burden to prove that they made full disclosure to the settlor.

The Code's comments would be the ideal place to emphasize the difference in treatment of professional and non-professional trustees, and to reinforce the approach that a majority of courts have taken to the problem. Instead, the comments suffer from a failure to take into account the differences between the professional and non-professional settings. In so doing, they gut the protections provided for by the Code's black letter, at least with respect to professional trustees.

Specifically, the comments provide a safe harbor for trustees who deal with settlors represented by counsel.[111] The comments create two *conclusive* presumptions about the settlor who was represented by counsel. The first states that the settlor's attorney shall be presumed to be the trust instrument's drafter, even if the trustee supplied the trust

[110] *See* Langbein, *supra* note 85, at 1124 (acknowledging that a waiver of trustee's duty to act in good faith "must have been improperly concealed from the settlor or otherwise misunderstood by the settlor when propounded").

[111] Section 1008(b) provides that "[a]n exculpatory term drafted or caused to be drafted by the trustee is invalid as an abuse of a fiduciary or confidential relationship unless the trustee proves that the exculpatory term is fair under the circumstances and that its existence and contents were adequately communicated to the settlor." UNIF. TRUST CODE § 1008(b) (2005). The comments to subsection (b) indicate that it was intended to disapprove of Marsman v. Nasca, 573 N.E.2d 1025 (Mass. App. Ct. 1991), which validated an exculpatory clause that was drafted by the settlor's attorney, who was also named as a trustee. *Id.* at § 1008 cmt.

document form.[112] If taken seriously, this would mean that courts can no longer strictly construe the waiver against the professional trustee, since that professional can no longer be viewed as "the drafter." More troubling, the second conclusive presumption is that the represented settlor had full information regarding the existence and meaning of any exculpatory provision.[113] The comments also provide that the settlor's lawyer's knowledge of the clause shall be imputed to the settlor, regardless of whether the attorney actually informed the settlor about the clause.[114] Thus, the settlor represented by inadequate counsel is afforded absolutely no protection from overreaching by a professional trustee.

This "safe harbor" makes sense when viewed from the perspective of the non-professional trustee. Because exculpatory clauses are generally wealth-enhancing for the settlor, and because information asymmetries are unlikely to be significant in this context, it makes sense to allow non-professional trustees to rely on the bargained-for waiver. The "safe harbor" makes no sense, however, for professional trustees, at least from the settlor's perspective. Responsible trustees and attorneys do not need the benefit of a statute that imputes knowledge to their clients, because they will ensure that clients have actual knowledge and a fair understanding of any non-standard trust terms. The statutory provision benefits only those attorneys who violate ethical obligations, such as those who subordinate their clients' best interests to curry favor with institutional trustees.

The comments would do better to reinforce the disclosure-encouraging approach that the common law takes. The comments should distinguish between professional and non-professional trustees, suggest that broad exculpatory clauses rarely should be used by professionals, and provide that, if such clauses are used, the professional trustee has the burden to prove full disclosure and consent regardless of whether the settlor was represented by counsel.

CONCLUSION

[112] The comments to section 1008 state that:

> The requirements of subsection (b) are satisfied if the settlor was represented by independent counsel. If the settlor was represented by independent counsel, the settlor's attorney is considered the drafter of the instrument even if the attorney used the trustee's form. Because the settlor's attorney is an agent of the settlor, disclosure of an exculpatory term to the settlor's attorney is disclosure to the settlor.

UNIF. TRUST CODE § 1008 cmt. (2005).

[113] *Id.*

[114] *Id.*

There are sound reasons to have separate fiduciary standards for non-professional and professional trustees. Courts intuitively understand this, and have developed fact-specific standards to take account of the particular difficulties that non-professional trustees face. The argument that classic fiduciary rules should be weakened to protect the non-professional should be rejected; generally, courts offer adequate protection to non-professionals. Traditional fiduciary rules, such as the no further inquiry rule and the prohibition against delegation of the investment function, grew organically from the need to compensate for information asymmetries and market imperfections in the trust context. Because the UTC and other statutes gut those strict standards, they will generate serious costs for beneficiaries in the coming years. To the extent those statutes suggest that courts ought to abandon the sensible common law approach to fiduciary duty issues, they are severely misguided.