Jurisdictional Competition to Abolish the Rule Against Perpetuities: R.I.P. for the R.A.P

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The Rule Against Perpetuities ("the Rule") may be on its last legs. Over the last decade, legislatures across the nation have been abolishing, or substantially curtailing, the common law rule that, despite its renowned complexity, has endured for more than 300 years. Why the dramatic change in what had once been a sleepy enclave of property law? In part, the answer lies with the exemption from the generation-skipping transfer tax, which has prompted wealthy people and their advisors to press for the right to create dynasty trusts, forever insulated from estate taxation. In part, the Rule's complexity, combined with broader availability of malpractice relief against lawyers, has created pressure from within the bar.

While these pressures might have been sufficient, by themselves, to generate abolition of the Rule within any single
state, competition among the states has hastened the move toward abolition. Several state legislatures—stimulated by entrepreneurial lawyers—have sought to attract trust business by relaxing long-established constraints on trusts, including but not limited to the Rule Against Perpetuities.4

Is this competition among states a “race to the top,” cleansing the legal system of an arcane rule that has outlived its usefulness?5 The answer is uncertain. Because perpetuities reform in one state has effects outside the state, competition among states does not guarantee an efficient perpetuities regime. Closer examination reveals that abolition of the Rule is likely to generate inefficiencies. Those inefficiencies, however, will not appear for decades, a period so long and so fraught with other uncertainties that potential inefficiency provides a weak basis for opposing the Rule’s abolition.

I. ABOLISHING THE RULE: WHY DOES ANYONE CARE?

John Chipman Gray offered the classic statement of the Rule Against Perpetuities: “No interest is good unless it must vest, if at

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5 The “race to the top” metaphor originated as a response to William Cary’s argument that interstate competition for corporate charters was a “race for the bottom” with Delaware leading the race to reduce protection for shareholders in order to attract corporate managers, who would make decisions about where to charter the corporation. William L. Cary, Federalism and Corporate Law: Reflections Upon Delaware, 83 YALE L.J. 663, 705 (1974).


all, not later than twenty-one years after some life in being at the creation of the interest. The Rule has often been described as a compromise permitting a property owner to control the disposition of her property for the lifetime of persons whose propensities she knows and fears, and for twenty-one years thereafter, but not beyond the period during which decedent might plausibly assert some special knowledge of the propensities of one of her beneficiaries.

Within a limited academic community, the Rule has long stirred passions out of all proportion to its practical impact. Fifty years ago, Harvard’s Barton Leach published two articles whose titles—Ending the Rule’s Reign of Terror and Staying the Slaughter of the Innocents—reflect his conviction that the Rule was a legal nightmare in need of immediate reform. In the 1970s, professors from Harvard and Columbia law schools waged battle at the American Law Institute over the appropriate shape of perpetuities reform. And in the 1980s, Professors Dukeminier and Waggoner joined the issue in a series of high-profile articles—Dukeminier supporting “wait-and-see” as the appropriate vehicle for perpetuities reform, Waggoner arguing that a future interest should be upheld, even if it violated the common law Rule, so long as the interest actually vested within a period of ninety years from the date of the interest’s creation.

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7 See ARTHUR HOBHOUSE, THE DEAD HAND 188 (1880):
A clear, obvious, natural line is drawn for us between those persons and events which the Settlor knows and sees, and those which he cannot know or see. Within the former province we may trust his natural affections and his capacity of judgment to make better dispositions than any external Law is likely to make for him. Within the latter, natural affection does not extend, and the wisest judgment is constantly baffled by the course of events. I submit, then, that the proper limit of Perpetuity is that of lives in being at the time when the settlement takes effect.

Id.; see also JOEL C. DOBRIS, STEWART E. STERK & MELANIE B. LESLIE, ESTATES AND TRUSTS 822-23 (2003).
11 Lawrence W. Waggoner, The Uniform Statutory Rule Against Perpetuities: The
Although many states did enact one reform measure or another, pressure for outright abolition of the Rule did not arise until after 1986, when Congress enacted the generation-skipping transfer tax.\(^2\) The federal estate tax is designed to be a once-a-generation tax on wealth, but until 1986, wealthy property owners could skip a generation (or sometimes two generations) of tax by making transfers—generally in trust—to grandchildren or even more remote descendants.\(^3\) The generation-skipping transfer tax closed that loophole by subjecting these transfers to a separate tax. At the same time, however, Congress included an exemption of $1,000,000 per transferor.\(^4\) Because Congress had reduced the opportunity to avoid estate taxation, and simultaneously created an exemption from the new tax, pressure inevitably arose to make the exemption as valuable as possible. A transferor could derive maximum value from the exemption by creating a trust that would last as long as possible, and preferably forever, so that the trust property would never be subject to estate taxation in any other person’s estate.\(^5\) The principal doctrinal obstacle to perpetual trusts—sometimes called “dynasty trusts”—was the Rule Against Perpetuities.\(^6\)

As Congress was enacting the generation-skipping transfer tax, state courts were expanding the scope of malpractice liability to will beneficiaries whose inheritance had been lost as a result of lawyer incompetence. Historically, will beneficiaries could not recover on malpractice claims because they were not in “privity.”

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\(^3\) For illustration, suppose decedent’s will had left her entire estate to a trustee, with income payable to her child for life, and directions to distribute the principal, at the child’s death, to decedent’s grandchildren. Estate tax would be due at decedent’s death (assuming her estate was large enough to be subject to estate taxation), but no tax would be due at the child’s death (because the child had no estate). For more discussion of the mechanics, see DOBRIS, STERK & LESLIE, supra note 7.

\(^4\) 26 U.S.C. § 2631(a) (2002). Note that the exemption is indexed for inflation, 26 U.S.C. § 2631(b), with the exemption for 2003 being $1,120,000.


\(^6\) The Rule Against Perpetuities does not directly limit trust duration; even in states where the Rule remains in effect, a settlor can create a trust that might endure for longer than the Rule’s period. For an example, see Robert J. Lynn, Perpetuities Literacy for the 21st Century, 50 OHIO ST. L.J. 219, 221 (1989). Lynn demonstrates that if a trust beneficiary’s interest “vests” within the period of the Rule, that beneficiary’s interest may continue to be held in trust for that beneficiary’s lifetime, even if the beneficiary’s lifetime exceeds lives in being at the trust’s creation plus twenty-one years. But the Rule does effectively limit trust duration, because the interest of each trust beneficiary—whether a beneficiary of income or of principal—must vest within the period of the Rule.
with the lawyer who had botched the will. And because the estate itself had not been diminished in size by the drafting error, the executor could not recover as a representative of the now-deceased testator. As a result, the failure of a lawyer to understand the Rule Against Perpetuities bore no significant risk of liability for error, despite the slaughter of some of Barton Leach's "innocents." As state after state abolished or liberalized the privity rule in the estate context, the Rule's complexity—and the potential for error—loomed as a potential source of lawyer liability. Lawyer self-interest joined tax avoidance as a reason to abolish the Rule.

II. COMPETITIVE PRESSURE TO ABOLISH THE RULE

Two states, Idaho and Wisconsin, have long held that the Rule Against Perpetuities does not apply to interests held in trust. In 1983, however, the South Dakota Legislature started a new wave of competition by abolishing the common law Rule entirely. Although the legislature maintained restrictions on suspension of the power of alienation of property, the legislature explicitly provided that "there is no suspension of the power of alienation by a trust... if the trustee has power to sell, either express or implied...." Unlike the legislation in Wisconsin and Idaho, however, the South Dakota legislation was part of an aggressive campaign to attract trust and banking positions to the

17 See, e.g., Barcelo v. Elliott, 923 S.W.2d 575 (Tex. 1996) (discussing, and adhering to, the common law rule).
18 See Martin D. Begleiter, First Let's Sue All The Lawyers—What Will We Get: Damages for Estate Planning Malpractice, 51 HASTINGS L.J. 325, 327 (2000) (noting that as of 1999, only six states retained a rule of absolute privity prohibiting will beneficiaries from bringing action against drafting attorneys).
19 See Dukeminier, supra note 3, at 153 (arguing that malpractice liability would stimulate lawyers to reform rules that impose needless costs).
20 The Idaho statute provides expressly that "there shall be no rule against perpetuities applicable to real or personal property"; the statute prohibits only suspension of the power of alienation for a period longer than lives in being plus twenty-five years, and only in the case of real property. IDAHO CODE § 55-111 (2002).
Just a few years earlier, South Dakota had repealed its interest rate ceiling on consumer credit cards, luring Citibank’s credit card business to the state. South Dakota has cemented its reputation as a trust-friendly jurisdiction by rejecting a state income tax. And it has been reported that South Dakota continues to seek other avenues to expand its trust business.

Following South Dakota’s lead, Delaware and Alaska substantially watered down their own versions of the Rule Against Perpetuities. In both states, the effort was combined with legislation authorizing asset protection trusts in an explicit effort to attract trust business from other states. In 1995, Delaware enacted legislation to exempt trusts of personal property from all perpetuities restrictions. If a Delaware trust includes real property, the Delaware statute requires distribution of the real property within 110 years from the later of the time the property is purchased by the trust or the trust becomes irrevocable. In 1997, the Alaska legislature amended its perpetuities statute—then derived from the Uniform Statutory Rule Against Perpetuities (USRAP)—to provide that a non-vested property interest is valid, even if it contains interests which will not vest within the Rule’s period, so long as “all or part of the income or principal of the trust may be distributed, in the discretion of the trustee, to a person who is living when the trust is created.” Although this statute was designed to permit dynasty trusts, the language itself was problematic, leading the Alaska legislature to further enact amendments clarifying the State’s abolition of the Rule Against Perpetuities as a limit on trust duration.

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23 SL 1979, ch. 335, § 2 (repealing S.D. Codified Laws § 54-11-6). South Dakota repealed the usury ceiling in response to the Marquette Bank case, which made it clear that a national bank may charge interest rates applicable in the state where the bank is located, regardless of a usury ceiling in effect in the depositor’s state of domicile. See Marquette Nat’l Bank of Minneapolis v. First of Omaha Serv. Corp., 439 U.S. 299 (1978).

24 See generally Christopher C. DeMuth, The Case Against Credit Card Interest Rate Regulation, 3 YALE J. ON REG. 201, 215-16 (1986).


26 See Pierce H. McDowell, III, Trust Forum Shopping: The Next Generation, TRUSTS & ESTATES, Aug. 1997, at 10 (noting that South Dakota’s governor was pushing a task force to expand legislative prowess in enacting trust legislation).


28 25 DEL. CODE § 503(b) (2002).

29 ALASKA STAT. § 34.27.050(a)(3), added by SLA 1997, ch. 6, § 6.

30 Id. § 34.27.051, entitled “Statutory Rule Against Perpetuities,” applies only with respect to powers of appointment, and is designed only to save potential trust settlers from the pitfalls of the “Delaware Tax Trap.” See Greer, supra note 15, at 278-82. ALASKA STAT. § 34.27.075 provides explicitly that the “common law rule against perpetuities does not apply in this state.” ALASKA STAT. § 34.27.051 (2002).
The race to permit perpetual trusts has not stopped there. Other states—perhaps acting in part to stem the flow of trust funds to South Dakota, Delaware and Alaska—have also abolished the Rule. In less than six years, at least fourteen states and the District of Columbia have abolished a rule that has been in place for four centuries.\(^\text{31}\)

Why compete for trust business? Trust business is good for a state's economy. If banks and trust companies expand within the state, or if new banks or trust companies set up shop, the state benefits from more jobs, and consequently more disposable income to stimulate the rest of the state's economy.\(^\text{32}\)

Moreover, if a state were to abolish the Rule Against Perpetuities in order to attract trust business, out-of-staters could not easily take advantage of the new legal regime without actually using the facilities of the state's banks or trust companies. It is true, of course, that the statutes abolishing the Rule Against Perpetuities do not expressly limit abolition to trusts created with a local trustee.\(^\text{33}\) But if an out-of-state settlor creates a trust using a trust company in her home state as trustee, that state's courts are not likely to apply Alaska law to validate a provision that violates the home state's Rule Against Perpetuities, even if the trust agreement expressly chooses Alaska law.\(^\text{34}\) Moreover, many trust settlors seeking to create perpetual trusts will also want to obtain the benefits of the asset protection rules of states like Alaska or Delaware, and the Alaska and Delaware statutes make those rules


These statutes vary considerably in operation, from outright abolition of the Rule, to exemption for all trusts, to exemption for trusts that include a provision opting out of the Rule. See generally 35-1 U. MIAMI L. CENTER EST. PLAN. 125 (2001).

\[^{32}\text{In this respect, trust business is different from the corporate charter business states seek to attract, from which state coffers can derive significant revenue. Indeed, Delaware draws a significant percentage of state revenue from corporate charters. ROMANO, supra note 5, at 6. With trusts, by contrast, states appear most concerned about drawing business to local financial institutions and lawyers.}^\

\[^{33}\text{Indeed, some statutes expressly provide that out-of-state trusts become subject to local law if the trusts declare an intention to be governed by local law. See, e.g., OHIO REV. CODE § 2131.09(B)(2) (2002).}^\

\[^{34}\text{As I have observed elsewhere, “courts have virtually never applied the law of the trust’s situs or the law expressly chosen by the settlor when the settlor chose situs or the law to evade a strong public policy of the settlor’s domicile.” Sterk, supra note 5, at 1086.}^\]
applicable only to trusts in which the trustee has a significant relationship to the state.\textsuperscript{35} Thus, if the settlor wants to avail herself of all of the advantages of Alaska or Delaware law, the settlor must use Alaska or Delaware institutions.

From the settlor’s perspective, using a Delaware or Alaska institution as trustee represents an insignificant constraint. Capital is extraordinarily mobile, so whether the trust property constitutes securities or cash, it will make little difference to the settlor whether legal title is held by a Delaware bank or a New York bank. If the law is more favorable in Delaware, an informed settlor would prefer to transfer assets to Delaware. The principal constraint on the flow of money to Delaware or Alaska is likely to be the reluctance of local lawyers and banks to advise settlors about out-of-state alternatives—alternatives that may siphon off their own business. Yet fiduciary duty—particularly of lawyers—may ultimately require them to advise clients about the advantages of out-of-state trusts.\textsuperscript{36}

Faced both with internal pressure to abolish the Rule, and with the prospect that Delaware and Alaska would attract trust dollars from local banks and trust companies, other states quickly began to respond by abolishing or significantly curtailing their own Rule Against Perpetuities. Because capital is so mobile, other states had little to gain by clinging to existing law; money would simply flow outward, so that the Rule would apply to less and less property.

The Uniform Statutory Rule Against Perpetuities (USRAP)—designed as a reform of the common law Rule rather than an abolition of perpetuities restrictions—contributed in some measure to the movement toward abolition.\textsuperscript{37} USRAP—drafted by some of the nation’s leading property scholars and approved by the National Conference of Commissioners on Uniform State Laws—upholds the validity of a non-vested property interest whenever the interest (1) satisfied the common law Rule or (2) actually vests or terminates within ninety years of its creation.\textsuperscript{38} By explicitly permitting any trust to endure for at least ninety years, the drafters of USRAP signaled that ninety-year trusts would do no significant harm to the social fabric. And if ninety years is unobjectionable, why not 150, or 200? Indeed, several

\textsuperscript{35} See ALASKA STAT. § 13.36.035(c) (2002); DEL. CODE ANN., tit. 12, § 3570(8) (2002).


\textsuperscript{37} The Uniform Statutory Rule Against Perpetuities has been incorporated into the UNIFORM PROBATE CODE §§ 2-901 - 2-906 (1990).

\textsuperscript{38} UNIFORM PROBATE CODE § 2-901(a) (1990).
jurisdictions enacted USRAP before, in short order, exempting qualified trusts from the Rule altogether. 39

III. COMPETITION, EFFICIENCY, AND EXTERNALITIES

An extensive literature suggests that competition among states tends to generate efficient legal rules. 40 The basic notion is that if a state develops inefficient rules, other states will exploit the inefficiency by offering more efficient rules that will draw businesses and residents away from the state with the inefficient regime. States with inefficient rules will respond in turn, leading to a "race to the top."

Embedded in the "race to the top" hypothesis, however, are several key assumptions. Among the most important are, first, that legislators act as rational maximizers of state interests; 41 second, that firms and individuals have the ability to move from state to state without significant cost; 42 and finally, that state regulation generates no significant externalities. 43 If these assumptions do not hold, competition does not guarantee efficient regulation. Of course, even if these assumptions prove untrue, it might be that the legal regime generated by competition turns out to be the most efficient regime; the problem is that the existence of competition will not, by itself, sort efficient legal regimes from inefficient ones.

In this light, consider the Rule Against Perpetuities as a

39 See, e.g., ARIZ. REV. STAT. § 14-2901(A)(3) (2002) (adding a provision to USRAP making nonvested interests valid whenever the interests are in trust with a trustee who has power to sell trust assets, and at some time, one or more persons living when the trust is created have an unlimited power to terminate).

40 The literature builds on Charles Tiebout’s 1956 article arguing that competition among municipalities could generate efficient provision of public goods because potential residents could choose the municipality that provided their preferred mix of public goods; leading municipalities, in turn, to adapt their mix of public goods to attract new residents until the cost of adding residents exceeded the benefit. Charles M. Tiebout, A Pure Theory of Local Expenditures, 64 J. POL. ECON. 416, 418-20 (1956).

The legal literature has adapted Tiebout’s argument to evaluate claims that competition among states, rather than municipalities, might generate efficient legal rules. The pioneering work was Ralph K. Winter, Jr., State Law, Shareholder Protection, and the Theory of the Corporation, 6 J. LEGAL STUD. 251 (1977). The legal literature has mushroomed over the past quarter century. For some of the leading works, see supra note 5.

41 For more extensive discussion of this assumption, see Julian Margolis, Public Policies for Private Profits: Urban Government, in REDISTRIBUTION THROUGH PUBLIC CHOICE 289 (Harold M. Hochman & George E. Peterson eds., 1974); Bratton & McCahery, supra note 5, at 237-38; Sterk, supra note 5, at 1056-61.

42 Tiebout, supra note 40, at 419.

43 Bratton & McCahery, supra note 5, at 231-33; Revesz, supra note 5, at 1222.
regulation of trust duration. Scholars and courts have identified a number of justifications for the Rule (or something like it). The Rule promotes alienability of land.^{44} The Rule promotes intergenerational equity.^{45} The Rule encourages entrepreneurial activity by limiting the period during which trust assets are subject to the conservative investment strategies historically pursued by trustees.^{46} The Rule reduces agency costs by limiting the time period during which beneficial ownership and control can be separated.^{47} The Rule limits the duration of spendthrift restrictions, which can themselves encourage inefficient behavior.^{48}

The next section examines the strength of these justifications. For present purposes, the important point is that the evils that underlie these justifications are evils whose primary impact will be felt in the state in which the trust beneficiaries live, not the state in which the trust, as a matter of form, is created. Consider, for instance, the supposed inefficiencies associated with spendthrift trusts. If a beneficiary knows his creditors—tort or contract—will not be able to reach his beneficial interest in trust, the beneficiary may take inadequate care to avoid doing harm to others because he will not ultimately bear the cost of that harm.^{49} That is, the spendthrift trust beneficiary who imposes loss on his creditor will not have to reduce his own expenditures or work to earn additional income to make the creditor whole. Although the beneficiary's careless actions might on occasion cause harm to out-of-staters, the effect of the beneficiary's actions will, in general, have the greatest effect in the area where the beneficiary is most likely to interact with others—in or near his home state.

In particular, if a New Yorker creates a perpetual spendthrift trust for the benefit of her descendants, the likelihood is small that any actions taken by the beneficiary-descendants will have a significant effect on Alaska creditors. Over time, it is likely that

^{44} See Dukeminier, supra note 9, at 1043-44; 4 AMERICAN LAW OF PROPERTY § 24.4 (1952).


^{46} See Chaffin, supra note 45, at 23-24.


^{48} See SIMES, supra note 45, at 56-60.

^{49} Indeed, spendthrift trusts insulate beneficiaries even from the consequences of their intentional torts. Scheffel v. Krueger, 782 A.2d. 410 (N.H. 2001) provides a recent and egregious example. A spendthrift trust beneficiary sexually assaulted a child, videotaped the assault, and broadcast the tape over the internet. The child recovered a judgment for more than $500,000, but the New Hampshire Supreme Court held that the child could not reach the trust income or principal to satisfy the judgment.
some of the beneficiaries will leave New York, but the chances that those beneficiaries will move to Alaska, or have significant dealings with Alaska creditors, is relatively small. As a result, if Alaska authorizes perpetual spendthrift trusts, Alaska does so with the knowledge that many of the costs such trusts engender will be felt outside Alaska. At the same time, if Alaska authorizes the creation of perpetual spendthrift trusts, Alaska will reap the full benefit of any trust business that migrates to Alaska because of its debtor-friendly legal environment.

This, in turn, creates pressure on larger states—New York included—to revise its legal system to avoid the exodus of trust business. The ultimate result is that even if it would be inefficient for each state to authorize perpetual trusts, both states would authorize such trusts. The decision to enforce perpetual trusts, in game theory terms, represents a Nash equilibrium,\(^5\) represented by the following illustration:

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<thead>
<tr>
<th></th>
<th>Enforce</th>
<th>Don't Enforce</th>
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<tr>
<td>New York</td>
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<tr>
<td>Enforce</td>
<td>(-2, -8)</td>
<td>(4, -14)</td>
</tr>
<tr>
<td>Alaska</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Don't</td>
<td>(-3, -7)</td>
<td>(0, 0)</td>
</tr>
<tr>
<td>Enforce</td>
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Assume as a baseline a regime in which neither state enforces perpetual trusts—a regime in which the common law perpetuities—or some near equivalent—operates to restrict trust duration. Assume further that if both states enforced perpetual trusts, each state would incur a significant cost, representing the inefficiencies associated with perpetual trusts. Assume that the cost would be two for Alaska and eight for New York, reflecting the greater potential for inflicting loss on creditors in a larger state. Assume further that if Alaska authorizes perpetual trusts but New York does not, New York will lose, and Alaska will gain, trust business with a value of six. If New York authorizes perpetual trusts, but Alaska does not, assume that Alaska will lose, and New York will gain, trust business with a value of one (reflecting the smaller pool of capital owned by Alaska residents).

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On these assumptions, Alaska would be better off abandoning its baseline regime and authorizing perpetual trusts. If New York chooses not to enforce perpetual trusts, Alaska is better off

enforcing those trusts: the payoff to Alaska increases from 0 to 4. Similarly, if New York chooses to enforce perpetual trusts, Alaska is also better off enforcing those trusts: its payoff increases from -3 to -2. Thus, whatever position New York takes, Alaska is better off enforcing perpetual trusts; for Alaska, enforcing these trusts is a weakly dominant strategy.51

But once Alaska enforces perpetual trusts, New York is also better off enforcing perpetual trusts: the payoff to New York increases from -14 to -8. And once both states enforce perpetual trusts, neither would be better off by unilaterally changing its rule to refuse enforcement to these trusts. As a result, the situation in which both states enforce—the set (enforce; enforce)—is a Nash equilibrium. By contrast, although the set (do not enforce; do not enforce) generates higher payoffs to both states, it is not an equilibrium set because Alaska has an incentive to change its rule to enforcement of perpetual trusts.

What this analysis demonstrates, then, is that competition among states cannot be relied upon to insure efficient regulation of trust duration. Because each state's regulation of domestic trusts creates external effects in other states, competition can, in fact, lead to inefficient regulation.

IV. IS THERE ANY INEFFICIENCY?: RE-EXAMINING THE RATIONALES FOR THE RULE

Because competition is an unreliable guarantor of efficiency, the question remains: does the Rule Against Perpetuities, or some comparable regulation of trust duration, protect against inefficiency? That the Rule once operated to limit inefficiency is clear. Leach and Tudor observed, half a century ago, that after seventeenth century English courts had enabled landowners to create indestructible executory interests, "some new rule seemed to be required to prevent the creation of an infinite series of contingent future interests which would effectively withdraw from commerce more and more land."52 The question, however, is

51 A dominant strategy is "a player's strictly best response to any strategies the other players might pick." Id. at 28.

whether the once-powerful efficiency justifications for the Rule survive into the twenty-first century.

A. Enhancing Marketability of Property

The Rule Against Perpetuities has often been justified as one in a collection of common law rules designed to make land more marketable.\(^5\) If a landowner were entitled to create a series of contingent future interests that would endure perpetually, the presence of those future interests—owned by persons not yet born—could make it impossible for a person who values the land to acquire a fee interest in that land. However important this justification might be with respect to legal interests in land, the justification does not apply to equitable interests held in trust.\(^4\) So long as the trustee has power to sell whatever land is held in trust (or whatever other assets the trust holds), concerns about marketability disappear.

B. Curtailing "Dead Hand" Control

Perpetuities scholars have often argued that limiting dead hand control of property serves as a coequal—or even primary—justification for the Rule.\(^5\) As one scholar has put it, the Rule helps to "strike a balance between the wishes of the dead and the desires of the living with respect to the use of wealth."\(^5\) But why strike such a balance? Why should the law limit a property owner's ability to control disposition of the property after his

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\(^5\) Gray, for instance, believed that "the system of rules disallowing restraints on alienation and the Rule against Perpetuities are the two modes adopted by the Common Law for forwarding the circulation of property which it is its policy to promote." JOHN CHIPMAN GRAY, THE RULE AGAINST PERPETUITIES § 2.1 (Roland Gray ed., 4th ed. 1942). Other common law rules promoting marketability include the rule making contingent remainders destructible and the prohibition on direct restraints on alienation. See generally 6 AMERICAN LAW OF PROPERTY §§ 24.4, 26.1 (1952).

\(^4\) See Dobris, supra note 19, at 635-36; Susan F. French, Perpetuities: Three Essays in Honor of My Father, 65 WASH. L. REV. 323, 352 (1990); Hirsch & Wang, supra note 47, at 20. The American Law of Property notes that the Rule was extended from legal to equitable interests "without discussion or recognition" of the differences between the interests. 6 AMERICAN LAW OF PROPERTY 16 (1952).


\(^5\) LYNN, supra note 45, at 10. See also LEWIS M. SIMES & ALLAN F. SMITH, THE LAW OF FUTURE INTERESTS § 1117 (2d ed. 1956) (arguing that the Rule "strikes a fair balance between the satisfaction of the wishes of the members of the present generation to tie up their property and those of future generations to do the same").
One answer rests on notions of intergenerational equity. Land is finite in quantity. If members of the present generation, in unison, were to create future interests that restricted the use and succession of land for 300 years, members of the next generation, or the generation to follow, would not enjoy comparable freedom: there would be no more land to restrict. And the argument was particularly powerful in an era during which land—far more than capital or labor—represented money and power. The Rule Against Perpetuities, by limiting the duration of dead-hand control, preserves for each generation a roughly comparable power to control the use and succession of land.

This argument, however, does not apply to equitable interests held in trust. So long as legal title to property, real and personal, is held in trust, that property is available for acquisition by members of each generation—so long as they create new wealth by dint of their own labor or capital in some combination. Members of each generation have equal power to generate wealth and to restrict its disposition. The Rule is not necessary to assure intergenerational equity.59

57 Richard Epstein has articulated the general argument against restricting dead hand control:

The grantor owns the property outright and could have consumed it completely... When the grant is made subject to condition, the grantee can either refuse to accept the limitation, or take it for what it is.... If the grantee does not like the restrictions, there is an easy out: he can reject the gift and acquire his own property by purchase and thus obtain absolute control over it.


58 See SIMES & SMITH, supra note 56, § 1117.

59 Of course within any individual wealthy family, the Rule may operate to limit the power of one generation to influence decisions by a subsequent generation. But so long as we are committed to the notion of freedom of disposition by the person who owns the property, it is not clear why the property owner should not be able to impose conditions of her own choosing on the objects of her bounty. As Epstein emphasizes, the property owner is entitled to consume the property, so the object of her bounty has lost nothing if the property owner instead disposes of the property subject to a variety of conditions. Epstein, supra note 57, at 705.

On the other hand, as a practical matter, no sensible person of means would consume all of her property before death simply because we do not know for sure when we will die. Indeed, leading economists once theorized that most saving is explained by the desire of individuals to insure a smooth consumption path during their lifetimes—to protect against inadequate income, particularly in old age. See Franco Modigliani & Richard Brumberg, Utility Analysis and the Consumption Function: An Interpretation of Cross-Section Data, in POST-KEYNESIAN ECONOMICS 388 (Kenneth K. Kurihara ed., 1954). If most people conserve resources rather than consuming them in order to assure adequate provision for their own futures, the hypothetical property owner with a legal entitlement to consume all of her resources may provide a weak foundation for Epstein's conclusion. And, indeed, Professor Melanie Leslie has argued first, that American courts permit less freedom of testation in practice than statutes appear to authorize, see Melanie
A second justification for limiting dead-hand control focuses on the costs imposed by long-term trusts: in particular, the agency costs associated with the separation of ownership from control and the inefficiencies associated with spendthrift restrictions. But the efficiency case for curtailing dead hand control must account for a very basic argument: the property owner is in the best position to make efficient decisions about its disposition, and if the property owner chooses to create a trust, she does so because the benefits of the trust form more than offset any attendant costs. Because the trust settlor has an interest in maximizing the value her beneficiaries derive from her property dispositions, efficiency concerns justify interfering with a settlor's control only when her dispositions have the potential to create negative externalities. Against that background, the next two sections consider the costs associated with long-term trusts.

1. Agency Costs and Tax Benefits

A trust, by definition, requires the separation of legal from beneficial ownership, or in terms familiar from other contexts, the separation of ownership from control. Separation of ownership from control inevitably generates agency costs. First, if we assume that each individual is best able to evaluate his or her interests, the trustee cannot evaluate the beneficiary's interests as well as the beneficiary can, leading to potential inefficiency. Second, even if the trustee fully understands the beneficiary's interests, the trustee may face incentives that induce him to

B. Leslie, The Myth of Testamentary Freedom, 38 Ariz. L. Rev. 235 (1996), and second, that assuring dutiful family members an appropriate inheritance often reflects an implicit agreement by the parties, see Melanie B. Leslie, Enforcing Family Promises: Reliance, Reciprocity, and Relational Contract, 77 N.C. L. Rev. 551 (1999). Taking Professor Leslie's argument one step further, one could argue that permitting a property owner to impose onerous conditions on inheritance would be inconsistent with the understanding of the members of the family unit.

60 See Epstein, supra note 57, at 705 ("The present owner can so tailor the terms of his grant to mediate in advance the potential conflicts amongst the subsequent grantees. His common grantees are in functional privity with each other because they are in actual privity with the grantor.").


sacrifice his personal interests to those of the beneficiary. In particular, the trustee has an interest in maintaining property in trust, even if the trust is unnecessary to serve the interests of the beneficiary, because the trustee's commissions will disappear when the trust terminates. In addition, potential liability for imprudent investments might lead a trustee to invest conservatively even when a more aggressive investment strategy would better suit the beneficiary's interest.

Why would a trust settlor impose these agency costs on her beneficiaries? One answer lies in the flexibility the family trust permits. By creating a trust, the settlor can tailor dispositions in ways that account for future circumstances of her beneficiaries. Suppose, for instance, settlor wants to divide her property among her children, but also wants to assure that her husband (perhaps by a second marriage) receives adequate provision during his lifetime. Settlor can achieve that objective by directing that the trustee pay income to the husband during his lifetime, or by conferring on the trustee discretion to make payments to the husband, out of income, out of principal or both.

If trusts offered no benefits other than increased flexibility, the efficiency case for regulating trust duration would be exceedingly weak. Before creating a trust, settlor (with the help of

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64 See Hirsch & Wang, supra note 47, at 29.
65 Dobris, supra note 19, at 629 n.119 ("There is the risk, not much noticed in current discussions (but real nonetheless), that a distant trustee may become a tyrant and may be unwilling to reduce or terminate a trust when it means the loss of trustee fee income.").
66 Professor Joel Dobris has observed, however, that trust investment reforms of the 1990s—particularly the Uniform Prudent Investor Act—reduces the incentive for the trustee to invest conservatively by importing modern portfolio theory into the trustee's investment obligations. Id. at 637.
67 Of course, agency costs like these are not unique to the trust relationship. Indeed, by private agreement, property owners often relinquish control of property when they see benefits that offset the agency costs generated by the separation of ownership and control. The purchase of shares in a publicly-held corporation furnishes the most obvious example. The modern corporation aggregates capital in a way that enables shareholders to obtain returns that might not otherwise be available, and provides professional management that frees the shareholder from day-to-day business decisions. Because of these evident advantages, corporate scholarship focuses not on reuniting ownership and control, but on decreasing agency costs in an environment that will continue to separate agency and control. See, e.g., Ronald J. Gilson & Reinier Kraakman, Reinventing the Outside Director: An Agenda for Institutional Investors, 43 STAN. L. REV. 863 (1991); Victor Brudney, Corporate Governance, Agency Costs and the Rhetoric of Contract, 85 COLUM. L. REV. 1403 (1985).

The ordinary family trust, however, does not generate the same efficiency advantages as the corporation. If their interests were not held in trust, beneficiaries could choose on their own whether to contract for professional management. However, the trust denies beneficiaries the power to make their own investment decisions. Moreover, in light of the forms of organization specifically designed for the aggregation of capital and the conduct of business—e.g., the corporation, the limited partnership, and the LLC—it is difficult to justify the family trust as a mechanism for aggregating capital.
legal and financial advisors) would compare the agency costs with the benefits associated with increased flexibility. Both the costs and the benefits would be felt by settlor's beneficiaries, not by third parties. As a result, settlor would have little reason to create the trust unless the trust's benefits exceeded their costs.

Trusts, however, offer benefits other than increased flexibility. In particular, under current law a settlor can significantly reduce (or postpone) future estate tax liability through appropriate use of trusts. For instance, settlors seeking to maximize the value of the $1,120,000 exemption from the generation-skipping transfer tax can do so most easily by creating a trust that will last for as long as possible.\textsuperscript{69}

Tax avoidance by property owners is not by itself inefficient.\textsuperscript{69} But introducing tax avoidance as a motivation for trust creation undermines the argument that a settlor would create a trust only when the trust's benefit exceeds its costs. The settlor has no incentive to consider the costs imposed on other taxpayers when the settlor avoids estate taxation. As a result, even when agency costs are high, settlor might create a trust to effect a transfer from the government (and presumably, other taxpayers) to the settlor and her beneficiaries—even though the transfer generates no social gain to offset the high agency costs.\textsuperscript{70}

Against this background, limits on trust duration remain a safeguard against inefficiency. Short-term trusts create limited potential for inefficiency. With respect to persons alive at a property owner's death—her living grandchildren, for instance—the property owner can obtain the benefit of the generation-skipping transfer tax exemption without using a trust at all. The property owner can simply make an outright gift to the grandchildren and, within the limit of the exemption, the property owner will avoid a full generation of estate taxation; no tax will be

\textsuperscript{68} See Greer, supra note 15, at 255-57.

\textsuperscript{69} For example, suppose a particular tax were inefficient. If taxpayers could all avoid the tax without cost, causing the government to raise money through a more efficient tax, tax avoidance might even generate efficiency gains. For a discussion of the relative efficiency of tax systems, see David A. Weisbach, Line Drawing, Doctrine, and Efficiency in the Tax Law, 84 CORNELL L. REV. 1627 (1999).

When tax avoidance entails cost (either out-of-pocket, like lawyer's fees, or substitution of a less preferred good for a more preferred good, like property held in trust for property held absolutely), the cost generated by avoidance is a deadweight loss. As Professor Weisbach puts it, “[d]eadweight loss results from the loss of consumer (and producer) surplus when comparing the after-tax world to the before-tax world.” Id. at 1650.

\textsuperscript{70} One way to erase this potential inefficiency would be to remove the potential for tax avoidance, either by abolishing the estate tax or by eliminating the tax benefits associated with trusts. And, indeed, the pressure to permit dynasty trusts would undoubtedly abate if Congress permanently abolished the estate tax.
due at the death of property owner’s children. If the property owner creates a trust instead of making an outright gift, she does so not to avoid taxation, but because she has decided that the greater flexibility of the trust form produces benefits that outweigh the agency costs associated with the trust.

It is only when a property owner seeks to avoid estate taxation for multiple generations that the trust becomes essential to her scheme; a property owner cannot make an outright gift to an unborn, unascertained descendant. At the same time, it is with multiple generation trusts that the supposed efficiency gains of the trust form become more speculative. The property owner has no special knowledge about the propensities of his great-grandchildren, and there is little reason to think that his prospective judgment, made two generations earlier, will better approximate the interests of the great-grandchildren than will the judgment of the great-grandchildren themselves. Of course, the trust settlor could compensate for his lack of personal knowledge by conferring powers of appointment on some of his descendants, but the value of that device, too, becomes more speculative when the settlor knows little about the judgment of the person on whom he has conferred the power.

This analysis suggests, then, that the Rule Against Perpetuities—or a comparable limit on trust duration—can operate to limit agency costs to those situations where there is good reason to believe that the costs are matched by compensating benefits. Once settlor creates a trust for beneficiaries whose propensities she does not know—the very trusts that would generally fall afoul of the Rule—there is less reason to believe that the trust’s agency costs are matched by those benefits.

2. Special Problems Associated with “Spendthrift” Provisions

Family trusts often include spendthrift provisions designed to insulate trust beneficiaries from creditor claims. These spendthrift provisions introduce agency costs; because the beneficial owner cannot bind the trustee to make future payments to an assignee rather than to the beneficiary personally, the beneficiary will not


72 This conclusion tracks Lord Hobhouse’s nineteenth century analysis, quoted supra note 7.
be able to serve his own interests as well as he would if he had more control of the trust property.

Spendthrift trusts, however, introduce costs beyond agency costs. By limiting the trust beneficiary's financial accountability for his actions, the spendthrift trust creates incentives for the beneficiary to impose external costs. Assume that tort law is calibrated to induce actors to engage in the optimal level of care. That is, tort law threatens a potential tortfeasor in that if the tortfeasor engages in conduct he should have avoided, the tortfeasor will be required to compensate potential victims for their losses. If, however, the threat of compensation is an empty one (because the tortfeasor's assets are held in a spendthrift trust, and therefore beyond the reach of the tort victim), the potential tortfeasor has less reason to take care and more reason to engage in activity that creates a risk of harm in others.73

The beneficiary's incentive to impose external costs extends beyond the tort context. Suppose the beneficiary has made a contract. Suppose further that the beneficiary is considering breach, which will impose costs on the promisee. Contract law generally enables the promisee to visit the costs of breach on the promisor, thus causing the promisor to internalize the cost of his own breach.74 But if the promisor is a spendthrift trust beneficiary guaranteed the right to enjoy income from the trust even if the promisor breaches his contract, the cost of the beneficiary's breach

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The expectation measure gives the parties to a bargain the appropriate incentives to perform rather than breach and to take appropriate precautions to ensure that they will be able to perform. Because the expectation measure places on the breaching party the loss of the other party's share of the contract's joint value, it sweeps that loss into each party's self-interested calculus in a decision whether to perform or to breach. Similarly, the expectation measure causes each party to internalize the cost of failure to take adequate precaution against breach, and therefore creates an incentive for efficient precaution.
will remain external to the beneficiary.\textsuperscript{75}

Nevertheless, spendthrift restrictions have historically been enforced as a reflection of the property rights of the trust settlor.\textsuperscript{76} The efficiency argument for deference to the settlor is two-fold: first, if denied the right to dispose of her property as she sees fit, the settlor might work less hard to accumulate property;\textsuperscript{77} and second, because settlor has special knowledge of the needs and "spendthrift" proclivities of some of her family members, she may be in the best position to tailor financial restrictions to the particular needs of those family members. The first of these arguments is of questionable validity,\textsuperscript{78} the second, as we have seen, has force only when the settlor has some concrete knowledge about the trust beneficiaries.\textsuperscript{79}

The common law Rule Against Perpetuities effectively prevents a trust settlor from creating a spendthrift trust that will last much beyond the lifetime of persons the settlor knows. In single-generation trusts permitted by the Rule, the rationale for enforcing spendthrift restrictions has some plausibility despite the

\textsuperscript{75} As David Carlson has noted, "[t]he greatest risk involved in lending is the moral hazard—the risk that the debtor will decline to pay interest on the principal lent." David Gray Carlson, Debt Collection as Rent Seeking, 79 MINN. L. REV. 817, 823 (1995). Professor Carlson goes on to note that the risk of debtor misbehavior is a private cost to creditors, and that creditors "will strive to avoid or reduce it." Id. Spendthrift trusts present a moral hazard problem because a judgment-proof trust beneficiary may breach with impunity. The fact that spendthrift trust beneficiaries cannot use their interest in the trust to induce potential creditors or contract partners to deal with them will prevent the completion of transactions of benefit to both the spendthrift and the potential contract partner (either because the creditor refuses to deal with the spendthrift altogether, or because the risk premium the creditor will charge makes the deal unattractive to the spendthrift).

For a somewhat unusual argument that spendthrift trusts are not inefficient—despite the moral hazard problems they create, see Hirsch, supra note 63, at 66-70. Hirsch argues in part that because debtors may lack the expertise to know how to avoid default, creditors may be better able to assess and avoid risk. Hirsch admits, however, that the case is at best ambiguous. Id. at 70.

\textsuperscript{76} The leading case remains Broadway National Bank v. Adams, 133 Mass. 170, 173 (1882), in which the court wrote: "The founder of this trust was the absolute owner of his property. He had the entire right to dispose of it, either by an absolute gift to his brother, or by a gift with such restrictions or limitations, not repugnant to law, as he saw fit to impose." Id.

\textsuperscript{77} See Hirsch & Wang, supra note 47, at 8:
Bracton’s assumption—shared by modern social scientists—was that persons derive satisfaction out of bequeathing property to others. To the extent that lawmakers deny persons the opportunity to bequeath freely, the subjective value of property will drop, for one of its potential uses will have disappeared. As a result, thwarted testators will choose to accumulate less property, and the total stock of wealth existing at any given time will shrink.

\textsuperscript{78} Id. (noting that once other reasons for accumulating wealth are considered, the economic impact of free testation may be quite small).

\textsuperscript{79} See text accompanying supra notes 71-72.
externalities spendthrift trusts can generate. In a world where trusts can endure forever, however, the rationale for enforcing spendthrift limitations evaporates. No efficiency gains counterbalance the negative externalities created by spendthrift restrictions. The Rule, then, operates to limit the inefficiencies associated with spendthrift restrictions.

V. LEGISLATIVE TIME HORIZONS: SHOULD LEGISLATURES CARE ABOUT THE INEFFICIENCIES OF PERPETUAL TRUSTS?

The preceding sections demonstrate first, that competition among states tends to drive states toward abolition of the Rule Against Perpetuities, and second, that the Rule continues to have a function. Without the Rule, or some substitute, settlors are likely to create trusts that generate agency costs and externalities without generating commensurate benefits. This section explains why—even apart from competitive pressures—these inefficiencies are unlikely to influence legislatures considering abolition of the Rule.

First, consider the obvious public choice explanation: the beneficiaries of perpetual trusts are concentrated and politically powerful banks and trust companies. By contrast, the parties most disadvantaged by perpetual trusts—beneficiaries frustrated in their ability to derive maximum advantage from trust monies/individual contract partners and tort creditors of spendthrift beneficiaries—are diffused throughout the population, with no organized political power. Hence, outside of the occasional law professor, the Rule Against Perpetuities will not have any significant champions.

Abolition would have virtually no effect on trusts created before the date of abolition. The drafters of those trusts—most of them competent lawyers—would have drafted them to comply with the common law Rule. As a result, these trusts will expire by their terms, and the trust property will be distributed to the trust beneficiaries free of any trust restrictions. Abolition will not

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80 See, e.g., MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION 125-28 (1971) (noting that the most successful interest groups are likely to be those in which each member has large interests at stake).

81 A legislature considering abolition of the Rule has two basic choices. First, the legislature could abolish the Rule prospectively. Prospective abolition would have no effect on existing trusts. Second, the legislature could abolish the Rule retroactively. But most trusts created before the date of abolition already comply with the Rule (except for those drafted by incompetent lawyers). As a result, even retroactive abolition would have an effect only on an infinitesimally small number of trusts.
extend the duration of these trusts, and therefore will not create any new inefficiencies with respect to these trusts.

Now consider the effect of abolition on trusts to be created in the future. The common law Rule Against Perpetuities permits settlors to create trusts that endure for a long time. A determined settlor can easily create a trust with an expected life span of fifty years, and in a jurisdiction that has adopted the Uniform Statutory Rule Against Perpetuities, a settlor can guarantee a trust life span of ninety years. During that period, current law tolerates the agency costs and externalities chronicled in the preceding section. If a state legislature abolishes the Rule, the legislature may be authorizing new inefficiencies—but those inefficiencies will not be felt by anyone in the state for at least half a century!

How, then, should a sensible and conscientious legislature act in the face of competitive pressures? First, there is no strong lobby in favor of retaining the Rule (at least with respect to interests held in trust). Second, even if the legislature believes that abolition of the Rule will create inefficiency in the distant future, circumstances could change so substantially over a fifty-year period to make today's tentative conclusions appear bizarre with the benefit of hindsight. Finally, even if today's assessment proves correct, and perpetual trusts do create future inefficiencies, future legislatures can deal with the problem in a variety of ways. For instance, legislatures (or courts) could alter rules affecting trust modification and termination to make it easier for trust beneficiaries to terminate trusts. In light of these factors, it would be quite natural for the legislature to abolish the Rule. And that, it appears, is what an increasing number will do.

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82 Professor Dukeminier reports that inquiries of estates lawyers at major New York and Los Angeles firms do not expect most trusts they draft to last for more than sixty years. Dukeminier, supra note 9, at 1045-46.


84 Indeed, Dukeminier has observed that England and the Canadian province of Manitoba have taken this approach, permitting beneficiaries to terminate a trust even when termination would contravene the settlor's intent. Dukeminier, supra note 9, at 1058, 1076-77.

Under current American law, trust termination would generally entail significant estate tax disadvantages—in particular, once a trust beneficiary receives legal title to trust principal, the principal will pass through the beneficiary's estate. This increased taxation would defeat a material purpose of the settlor, which, under current American law, would generally prevent judicial termination of the trust. See RESTATEMENT (SECOND) OF TRUSTS § 337(2) (“If the continuance of the trust is necessary to carry out a material purpose of the trust, the beneficiaries cannot compel its termination.”).

If estate taxation were abolished or significantly transformed, termination by the beneficiaries might no longer be inconsistent with the Restatement's position.