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Too Many Tiaras: Conflicting Fiduciary Duties in the Family-Owned Business Context

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ARTICLE

TOO MANY TIARAS: CONFLICTING FIDUCIARY DUTIES IN THE FAMILY-OWNED BUSINESS CONTEXT

Karen E. Boxx

ABSTRACT

Family-owned businesses have been called the “backbone of the U.S. economy,” but passing control of a family business to the next generation is so complex that the majority of family businesses do not survive the transition. A common scenario that leads to problems is where owners want to leave the business to their children but only one child is interested in and capable of managing the business. A popular solution is to leave the interested child an equal share of the business, together with management control, and leave the other children interests in the business in trust, with the manager child as trustee. This raises difficulties for the manager–trustee because the fiduciary duties of a trustee are much stricter than those of a business entity fiduciary. The children whose shares are in trust may also be disadvantaged if the manager–trustee child is able to use the lower business fiduciary standard to reduce the value of the trusts’ interests in the business. The resulting uncertainty and litigation increase the likelihood that the business will not survive. This Article first reviews the specific duties owed by trustees and by fiduciaries of the various business entity formats. It then analyzes the theories supporting imposition of fiduciary duty and the purposes of fiduciary duty in the various roles in order to determine what level of duty is essential to the trustee–business

* Associate Professor, University of Washington School of Law. I would like to thank Professor Thomas R. Andrews and Todd Maybrown for invaluable assistance in writing this article.
fiduciary. Next it reviews case law where courts have had to identify the applicable fiduciary duty for a dual-role fiduciary. Finally, it argues for a new, hybrid duty that allows for the flexibility to take on risk as needed in the business context and that accommodates the fiduciary’s personal interests in the business, but still recognizes the vulnerability of the trust beneficiary. A clearer level of duty tailored to this unique position would protect not only the business owners but all who benefit from the continued viability of the family business.

TABLE OF CONTENTS

I. INTRODUCTION ................................................................. 234

II. FIDUCIARY DUTIES AS DEFINED BY A SPECIFIC ROLE ....... 237
   A. General Principles of Fiduciary Duty .................................... 237
   B. Fiduciary Duties of a Trustee ........................................... 239
   C. Fiduciary Duties of Corporate Directors and Officers .......... 244
   D. Fiduciary Duties of Managers and Owners of Unincorporated Entities ............................................. 249
      1. General Partnerships ................................................. 249
      2. Limited Partnerships .............................................. 253
      3. Limited Liability Companies ..................................... 254
   E. Underlying Theories of Fiduciary Duty in the Business and Trust Contexts ........................................ 256
   F. Comparison of the Various Definitions of Fiduciary Duty ................. 260

III. WHEN ONE PERSON ACTS IN TWO FIDUCIARY CAPACITIES ........................................... 266
    A. The Estate of Harry Winston ....................................... 266
    B. Other Cases ............................................................. 274

IV. A NEW STANDARD FOR THE DUAL-ROLE FIDUCIARY ........ 285

V. CONCLUSION ................................................................. 290

I. INTRODUCTION

The family situation of Harry Winston, the famed jeweler, was similar to many closely held business owners. He had two

1. Harry Winston, a child of Ukrainian immigrants, opened Harry Winston, Inc. in
sons, one who graduated from Harvard with a degree in chemistry, worked in rocket research, and then entered the family business at the request of his father, and the other who dropped out of college and, according to many accounts, was uninterested in business affairs. When it came time to pass the business down to his sons, Mr. Winston had the same instincts as most parents in this situation: he wanted to treat his sons equally financially but also wanted his business-oriented son in charge of the company. He attempted to achieve this by leaving the business equally to the sons, but Ronald, the hardworking one, was a trustee, together with two professional trustees, for the share of his brother, Bruce. Ronald was also left in charge of running the business. The result of this estate plan was twelve years of litigation between the brothers (and corresponding litigation against the other trustees lasting even longer).

The Winston estate illustrates the dilemma of both children in this scenario. The uninvolved child is at the mercy of his sibling, who has significant opportunity to exploit the position of power while being protected by imprecise and, in some instances, lax or nonexistent fiduciary standards of conduct. The child in charge of the business, if the child wants to discharge her fiduciary duties fairly, faces a more complex dilemma. That child must act both as corporate fiduciary, running the business in the best interests of all the stakeholders in the business, and as trustee to her sibling, owing undivided loyalty to this one shareholder.

Duties of a corporate fiduciary are much more lenient than that of a trustee, and when a person is holding both roles, courts are tempted to resolve the dilemma of judging the fiduciary’s conduct by applying the stricter standard to the fiduciary’s


Investors to Buy Major Stake of Harry Winston, N.Y. TIMES, Dec. 21, 2000, at B8. Winston donated the Hope Diamond to the Smithsonian Institution, and the song, Diamonds Are a Girl’s Best Friend, includes the line, “Talk to me Harry Winston.”

Id.; JULE STYNE & LEO ROBIN, Diamonds Are a Girl’s Best Friend, on GENTLEMEN PREFER BLONDIES (Music Sales Corp. 1949).


4. Burleigh, supra note 1, at 49.

conduct. However, there are economic reasons why a business manager must be given more leeway in running the business than a trustee is given in managing a trust. Holding the fiduciary to the stricter standard is arguably less protection to the beneficiary because the success of the business may be impaired. Also to be considered are the intentions of the transferor who set up this conflict. If the transferor’s intent was to allow maximum flexibility to the fiduciary child, then that intent may be thwarted by the higher standard. On the other hand, application of the lower (and some have argued, now nonexistent) corporate fiduciary duty ignores the absence of the balancing protections available in most corporate settings that offset the fiduciary’s relative freedom, such as the shareholder’s ability to sell the investment and thus withdraw from the relationship if the corporate fiduciary is abusing the freedom. The lesser standard can therefore leave the uninvolved child with no protection from exploitation by the business-manager sibling. The answer cannot be as simple as choosing one standard over the other but rather requires fashioning a distinct standard that both protects the beneficiary and allows sufficient management autonomy to allow the business to prosper.

This is not an easy task, in light of the current uncertainties over the appropriate extent of fiduciary duties of both trustees and business managers. The tenor of the debate in the trust context is much more constrained than in the business fiduciary context, in light of the long history of strict duty for trustees, but in both arenas the general point at issue is the extent to which fiduciary duties should be mandatory and fixed, or waivable like contractual terms. In the business context, the statutory trend is a significant reduction in mandatory fiduciary duties.

Family businesses, called the “backbone of the [U.S.] economy,” regularly struggle with succession planning, and this legal uncertainty can be a significant threat to such a business’s

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7. *See infra Part II.E.*


survival. Analysis of the problem would not only be advantageous to business succession planning but also can advance the continuing scholarly debate regarding the evolution of fiduciary duty in the trust and business entity contexts.

This Article will first summarize the evolution and current formulation of duties of trustees and of various business managers in the corporate, partnership, and limited liability corporation models. It will next explore the theoretical approaches to fiduciary duty, how those approaches have affected the different roles of trust and corporate fiduciary, and how the different theories affect potential future shifting of those duties. The Article will then consider the justifications for the discrepancies in the different roles in order to determine which level of duties is appropriate for the dual-role fiduciary. The next section will visit the Winston family saga and similar family-business struggles and analyze the dual-role fiduciary and how courts have dealt with the conflicting duties. The Article then proposes an approach to defining the parameters of such a fiduciary’s unique duties.

II. FIDUCIARY DUTIES AS DEFINED BY A SPECIFIC ROLE

A. General Principles of Fiduciary Duty

While a unified definition of fiduciary has yet to be agreed upon, the essence of a relationship found to be fiduciary is open-ended control by one person over property owned by another person or other discretionary power of one person over another. The fiduciary has been entrusted with this power and has been given some level of unsupervised discretion, so the label of fiduciary, with its attending duties, is imposed to substitute for the lack of supervision. Once the label of fiduciary attaches, the


11. See P.D. Finn, The Fiduciary Principle, in EQUITIES, FIDUCIARIES AND TRUSTS 1, 24 (T.G. Youdan ed., 1989) (“It is striking that a principle so long standing and so widely accepted should be the subject of the uncertainty that now prevails.”); Robert W. Hillman, Closely-Held Firms and the Common Law of Fiduciary Duty: What Explains the Enduring Qualities of a Punctilio?, 41 TULSA L. REV. 441, 442 (2006) (“As law goes, fiduciary doctrine is long on generalities and short on substance.”).


person entrusted with the power is encumbered with the duty to act unselfishly, and breaches of such duty are punished more harshly than mere breaches of contract. The extent of the unselfishness required depends on the specific relationship. The more power the fiduciary has, and the less power and control the beneficiary of the relationship has, the higher the duty. As stated by Professor Scott:

The greater the independent authority to be exercised by the fiduciary, the greater the scope of his fiduciary duty. Thus, a trustee is under a stricter duty of loyalty than is an agent upon whom limited authority is conferred or a corporate director who can act only as a member of the board of directors or a promoter acting for investors in a new corporation.

The purpose of the fiduciary label is to prevent abuse of the position. In economic terms, it can reduce agency costs, the costs of separating ownership and management. Any time risk-bearing (by the equity owners, such as trust beneficiaries or corporate stockholders) is separated from managing the assets (delegated to the trustee or corporate managers), the managers’ incentives to get the highest return and otherwise protect the assets are weakened because any profit (and any loss) goes to the risk-bearer. In order to avoid loss due to the manager’s lack of self-interest in the transactions, the risk-bearer must monitor the manager’s actions, provide financial incentive, and be able to recover from

1399, 1482 (2002) ("[T]he purpose of fiduciary duty is to combat opportunism in such relationships.").

14. RESTATEMENT (THIRD) OF TRUSTS § 78 & cmt. a (2007); Frank H. Easterbrook & Daniel R. Fischel, CONTRACT AND FIDUCIARY DUTY, 36 J.L. & ECON. 425, 441 (1993) (stating that damages for breach of contract are usually limited to the promisee’s loss, while damages for breach of fiduciary duty usually include all profits obtained by the fiduciary due to the breach). In addition, if a trustee breaches her duty of loyalty by self-dealing (i.e., transacting with the trust in her individual capacity), then there is no further inquiry and the transaction is voidable by the beneficiaries regardless of the fairness of the transaction. GEORGE GLEASON BOGERT & GEORGE TAYLOR BOGERT, THE LAW OF TRUSTS AND TRUSTEES § 543, at 247–48 (2d ed. rev. 1993).


16. Id.

17. Id.

18. See Smith, supra note 13, at 1482.


20. Frank H. Easterbrook & Daniel R. Fischel, CLOSE CORPORATIONS AND AGENCY COSTS, 38 STAN. L. REV. 271, 277 (1986); see LEX DONALDSON, AMERICAN ANTI-MANAGEMENT THEORIES OF ORGANIZATION 165 (1995) ("Agency theory tends to see managers as ever ready to cheat the principals or owners unless constantly controlled in some way.").
the manager for poor performance. These agency costs—i.e., the costs of maintaining the agency relationship—are a consideration whenever risk-bearing and management are separated, and fiduciary duty (and potential liability for its breach) is one means to keep the manager in check.

Essentially, there are two fiduciary duties: the duty of care and the duty of loyalty. The duty of care is the duty to perform competently and includes the duty to carry out the fiduciary purpose—to be prudent in one’s actions; to protect property entrusted to the fiduciary in the fiduciary capacity; to earmark such property and not to commingle with the fiduciary’s own assets; to invest such property prudently, which may include a duty to diversify; to account to the beneficiaries; and to be impartial in the treatment of the persons who hold an interest in the fiduciary property. The duty of loyalty is the duty of unselfishness, the duty to refrain from exploiting the relationship for personal gain and to refrain from taking any benefit from the relationship other than reasonable compensation. Breaches of the duty of care generally are punished less severely than breaches of the duty of loyalty, but the strictness of each duty varies significantly depending on the type of fiduciary role.

B. Fiduciary Duties of a Trustee

The trustee is the most vertical of the fiduciary relationships because the beneficiary has virtually no control over the trustee’s actions, restricted ability to monitor the trustee’s actions, and restricted ability to exit the relationship by removing the assets

22. Michael Jensen and William Meckling, in their classic 1976 essay on agency costs, defined agency costs as “(1) the monitoring expenditures by the principal, (2) the bonding expenditures by the agent, (3) the residual loss.” Michael C. Jensen & William H. Meckling, Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure, 3 J. Fin. Econ. 305, 308 (1976) (footnote omitted).
23. See Sitkoff, supra note 19, at 677–83 (contrasting the effect of fiduciary rules to curb agency costs in trusts and corporations).
from the trustee’s control. There is also no other monitoring mechanism in place to protect the beneficiary, such as court supervision in a guardianship or market forces affecting the price of stock in a publicly held corporation. The trustee’s fiduciary duties are therefore among the most stringent, setting the gold standard for fiduciary unselfishness, and all other fiduciary relationships descend from that standard.

So what is that gold standard? The duties of a trustee will primarily be defined by the terms of the individual trust instrument. However, state statutes and the common law provide both default rules, which apply in the absence of provisions of the trust instrument, and mandatory rules, which apply regardless of the provisions of the trust instrument.

A trustee’s duty of loyalty under common law prohibits self-dealing, except when the settlor of the trust authorized the transaction or all of the beneficiaries consented after full disclosure. Self-dealing includes not only transactions between the trust and the trustee in her individual capacity, but also transactions between the trust and an alter ego of the trustee, such as a straw man, close relative, or an entity substantially owned by the trustee. Whether the relationship between the trustee and third party to the transaction is close enough to trigger self-dealing rules is usually a question of fact. Self-dealing is generally prohibited even if the price is set by a third party.

If a trustee engages in self-dealing, then the transaction is voidable at the option of the beneficiary, regardless of whether

31. See Smith, supra note 13, at 1452–54 (describing trusts as “quintessential fiduciary relationships” and quoting the Restatement for the proposition that the “duties of a trustee are more [rigorous] than those of most other fiduciaries” (quoting RESTATMENT (THIRD) OF TRUSTS § 2 cmt. b (2003)) (internal quotation marks omitted)).
34. 1 RESTATEMENT (SECOND) OF TRUSTS §§ 170(1) cmt. t, 216(1), (2)(b) (1959).
35. 3 SCOTT, FRATCHER & ASCHER, supra note 25, §§ 17.2.1.3 to .4, at 1095–1102.
36. See BOGER & BOGER, supra note 14, § 543(a), at 281–82.
37. 3 SCOTT, FRATCHER & ASCHER, supra note 25, § 17.2.1.2, at 1091.
the transaction was otherwise fair to the trust. The beneficiaries have a broad range of remedies, including requiring the trustee to pay over to the trust any profit made by the trustee, requiring the trustee to return the property to the trust, or requiring the trustee to pay into the trust the difference between the fair market value and the price paid by the trustee. The beneficiaries can also elect to confirm the sale if the property’s value drops below what the trustee paid. Fairness of the transaction to the trust is not a defense; the mere fact of self-dealing triggers the beneficiaries’ remedies. This “no further inquiry” rule is justified on the principle that it is a breach of the trustee’s duty merely to put himself in a conflict of interest with the trust; taking unfair advantage of the conflict is not a necessary element of the breach. According to Robert Cooter and Bradley Freedman’s economic rationale for the no further inquiry rule, the potential for unfair profit for the self-dealing trustee is too great, and the likelihood of getting caught is too small (because of the obstacles to supervising the trustee), so the more common contractual remedy of disgorging only the difference between a fair sale and the actual sales price would not be a sufficient deterrent to bad behavior. The stiffer penalties of the no further inquiry rule are therefore necessary to compensate for the inadequate supervision.

Self-dealing may be authorized by the trust instrument, but the trust instrument cannot relieve the trustee of the duty to act in good faith and in furtherance of the trust purposes.

38. Id. § 17.2, at 1078–80; see Fulton Nat’l Bank v. Tate, 363 F.2d 562, 571 (5th Cir. 1966) (“[T]he beneficiary need only show that the fiduciary allowed himself to be placed in a position where his personal interest might conflict with the interest of the beneficiary. It is unnecessary to show that the fiduciary succumbed to this temptation, that he acted in bad faith, that he gained an advantage, fair or unfair, that the beneficiary was harmed. Indeed, the law presumes that the fiduciary acted disloyally, and inquiry into such matters is foreclosed.”).

39. 3 SCOTT, FRATCHER & ASCHER, supra note 25, § 17.2.1.1, at 1089–90.

40. Id. at 1090–91.

41. 2A AUSTIN WAKEMAN SCOTT & WILLIAM FRANKLIN FRATCHER, THE LAW OF TRUSTS § 170.1, at 316 (4th ed. 1987) (“It is now, of course, well settled in the United States as well as in England that a sale by a trustee to himself individually can be set aside if it was made without the consent of the beneficiaries, even though it was made in good faith and for a fair consideration.”).

42. 3 SCOTT, FRATCHER & ASCHER, supra note 25, § 17.2.1, at 1087; see also BOGERT & BOGERT, supra note 14, § 543, at 228 (“[E]quity deems it better to . . . strike down all disloyal acts, rather than to attempt to separate the harmless and the harmful by permitting the trustee to justify his representation of two interests.”); Sitkoff, supra note 30, at 573–74.

43. Cooter & Freedman, supra note 13, at 1051–54, 1074.

44. Id.

45. 3 SCOTT, FRATCHER & ASCHER, supra note 25, § 17.2.11, at 1138–39.

46. UNIF. TRUST CODE § 105(b)(2) (amended 2005), 7C U.L.A. 428–29 (2006); 1 RESTATEMENT (SECOND) OF TRUSTS § 170(1) cmt. t (1959) (“By the terms of the trust the
A trustee’s duty of care is similarly construed very strictly. The duty was originally phrased as the duty to exercise such care as a person of ordinary prudence would exercise in dealing with his or her own property with an eye towards long-term preservation of the estate. The prudent person rule has been updated to the “prudent investor” rule, clarifying that the trustee’s decisions should be based on the purposes and circumstances of the trust and its beneficiaries. The hallmark of the trustee’s duty of care is minimizing risk: “[T]he trustee must accept only that level of overall risk that is appropriate, in light of all the circumstances, for the trust and its beneficiaries.” The trustee’s duty of care has even been phrased as a duty of caution. As stated in the comments to the Uniform Prudent Investor Act, “A trust whose main purpose is to support an elderly widow of modest means will have a lower risk tolerance than a trust to accumulate for a young scion of great wealth.”

The duty of care includes the duty to delegate responsibly, which originally was the duty not to delegate but which by necessity evolved to permission to delegate as long as the trustee used “reasonable care, skill, and caution” in selecting the agent and in monitoring the agent’s actions. The reason for this evolution was the increasing complexity of financial markets and investment decisions, making it necessary for lay trustees to rely on advisors. The trustee’s duty of care also includes the duty to preserve trust property, which includes the duty to exercise reasonable care to keep the property in good repair.

trustee may be permitted to sell trust property to himself individually, or as trustee to purchase property from himself individually, or to lend to himself money held by him in trust, or otherwise to deal with the trust property on his own account. The trustee violates his duty to the beneficiary, however, if he acts in bad faith, no matter how broad may be the provisions of the terms of the trust in conferring power upon him to deal with the trust property on his own account.”); 2A SCOTT & FRATCHER, supra note 41, § 170.9, at 346.

47. 2A SCOTT & FRATCHER, supra note 41, § 174, at 466–68.
49. 4 SCOTT, FRATCHER & ASCHER, supra note 25, § 19.1.5, at 1399.
54. 3 SCOTT, FRATCHER & ASCHER, supra note 25, § 17.8, at 1215–16.
keep and render accounts,\textsuperscript{55} the duty not to commingle trust assets with the trustee's personal assets,\textsuperscript{56} the duty to earmark trust assets as belonging to the trust,\textsuperscript{57} and the duty to make the trust property productive.\textsuperscript{58} The duty to keep trust assets separate and earmarked was traditionally read strictly; if there was any loss of value of unearmarked or commingled assets, the trustee was liable for the loss even if the failure to earmark or keep separate was not the cause of the loss.\textsuperscript{59} For example, the trustee who failed to earmark would be liable for a loss due to general decline in the stock market. The more modern approach is to hold the trustee liable for breach of these duties only if the loss was caused by the breach.\textsuperscript{60}

The trustee has a general duty to diversify trust investments in order to minimize risks.\textsuperscript{61} The trust instrument can relieve the trustee of the duty to diversify, but the trustee is still required to exercise prudence and caution\textsuperscript{62} and may still be liable for failing to diversify if circumstances indicate that diversification is nevertheless necessary to protect trust assets.\textsuperscript{63}

The duty of care can generally be relaxed by the trust instrument, but cannot eliminate “the fundamental requirement that trustees not behave recklessly but act in good faith, with some suitable degree of care, and in a manner consistent with the terms and purposes of the trust and the interests of the beneficiaries.”\textsuperscript{64} An exculpatory clause in the trust instrument will be strictly construed and will not be enforced to relieve a trustee of liability for gross negligence or deliberate behavior.\textsuperscript{65}

\textsuperscript{55} Id. § 17.4, at 1186–88.
\textsuperscript{56} Id. § 17.11.1, at 1228.
\textsuperscript{57} Id. § 17.11.3, at 1233.
\textsuperscript{58} Id. § 17.13, at 1248 (“Ordinarily, a trustee has a duty to use reasonable care and skill to make the trust property productive in a manner that is consistent with the fiduciary duties of caution and impartiality.”).
\textsuperscript{59} Id. § 17.11.1, at 1230, § 17.11.3, at 1235.
\textsuperscript{60} Id.
\textsuperscript{61} 4 SCOTT, FRATCHER & ASCHER, supra note 25, § 19.2, at 1427; see also Langbein, supra note 53, at 646–48.
\textsuperscript{62} 4 SCOTT, FRATCHER & ASCHER, supra note 25, § 19.3.2, at 1444–45.
\textsuperscript{63} See, e.g., Robertson v. Cent. Jersey Bank & Trust Co., 47 F.3d 1268, 1279 (3d Cir. 1995); First Ala. Bank of Huntsville, N.A. v. Spragins, 475 So. 2d 512, 516 (Ala. 1985); In re Estate of Jones, 681 N.E.2d 332, 337 (N.Y. 1997); see also RESTATEMENT (THIRD) OF TRUSTS § 91 cmt. f (2007) (discussing that while diversification instructions are typically permissive, as opposed to mandatory, such permissiveness does “not abrogate the trustee’s duty to act prudently . . . because diversification is fundamental to prudent risk management”).
\textsuperscript{64} RESTATEMENT (THIRD) OF TRUSTS § 77 cmt. d (2007).
\textsuperscript{65} 4 SCOTT, FRATCHER & ASCHER, supra note 25, § 24.27.2, at 1804.
C. Fiduciary Duties of Corporate Directors and Officers

In the corporate setting, the board of directors and the corporate officers are fiduciaries for the corporation and its shareholders and traditionally have been bound by the same general notions of a duty of care and a duty of loyalty as trustees. The fiduciary duties imposed can and should be less strict than that of a trustee, for several reasons. First, the shareholder is theoretically in a better position to protect his interests than a trust beneficiary because of ease of exit from the relationship, better monitoring, and general controls of the market. Also, in the business setting some risk is a necessary element, as opposed to the conservative goals of the trust, and self-dealing by business managers can benefit the business.

Fiduciary duties of corporate managers are currently defined much more narrowly and are further weakened by exceptions and presumptions in favor of finding no breach of duty. In addition, state statutes are moving in the direction of diluting the duty of loyalty and allowing fiduciary duties to be virtually eliminated by contract with the shareholders.

The duty of care is particularly weakened in the corporate setting. A typical statement of the duty of care is:

[A] duty to the corporation to perform the director’s or officer’s functions in good faith, in a manner that he or she reasonably believes to be in the best interests of the

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66. See 1 Stephen A. Radin, The Business Judgment Rule 1–2 (6th ed. 2009) (describing the duty of loyalty for directors as the duty to “maintain . . . the corporation’s and its shareholders’ best interests over anyone else’s” and the duty of care as an “obligation to act on an informed basis” (internal quotation marks omitted)).

67. See Sitkoff, supra note 30, at 570–73 (comparing interests of shareholders and trust beneficiaries). But see Adolf A. Berle, Jr. & Gardiner C. Means, The Modern Corporation and Private Property 355 (1932) (commenting that passive investors in corporations largely surrender “the right that the corporation should be operated in their sole interest” and the protection provided by the community for strict property rights).

68. See Easterbrook & Fischel, supra note 14, at 437 (giving reasons for variations in fiduciary duties of different relationships).

69. See Claire Moore Dickerson, Is It Appropriate to Appropriate Corporate Concepts: Fiduciary Duties and the Revised Uniform Partnership Act, 64 U. Colo. L. Rev. 111, 142–45 (1993) (observing, in RUPA, the shift from a duty of good faith for corporate partners to a lesser “obligation,” the allowance for parties to waive obligations for any conduct that is not “manifestly unreasonable,” and the reduced burden of proof when partners act in self-interest (internal quotation marks omitted)). For a history of the evolution of fiduciary duty in the corporate context, see id. at 123–40.

70. See infra notes 94–95 and accompanying text; see also Margaret M. Blair & Lynn A. Stout, Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law, 149 U. Pa. L. Rev. 1735, 1791 (2001) (“The net result is that, as a practical matter, a negligent director is more likely to be hit by lightning after leaving her board meeting than she is to pay damages.”).
corporation, and with the care that an ordinarily prudent person would reasonably be expected to exercise in a like position and under similar circumstances.71

The Model Business Corporation Act, aiming to avoid the tort law implications of prudent person language,72 phrases the standard as the care that “a person in a like position would reasonably believe appropriate.”73 The dilution of the duty therefore begins with the basic definition, which is more relaxed than the trustee’s corresponding duty to exercise care that a prudent person would exercise in handling his or her own affairs or in light of the circumstances of the trust beneficiaries.74

The duty of care in the corporate setting is even further softened by the business judgment rule.75 The business judgment rule creates a presumption that must be rebutted by a party claiming a violation of the duty of care.76 Under the business judgment rule, it is presumed “that in making a business decision, the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.”77 The purpose of the business judgment rule is to allow corporate managers sufficient discretion to manage the business enterprise while still acknowledging the underlying duty of care.78 The rule prevents a court from reviewing the substantive merits of a particular board decision as long as the procedure in making the decision complied with the requirements of the business judgment rule.79 As a result of the

71. 1 PRINCIPLES OF CORPORATE GOVERNANCE § 4.01 (1992).
73. MODEL BUS. CORP. ACT § 8.30(b) (2010).
74. See supra notes 45–51 and accompanying text.
75. The business judgment rule has a long history and has generated voluminous scholarly analysis. The complexities of the rule are beyond the scope of this Article. For a thorough analysis, see 1 RADIN, supra note 66, at 26–28.
78. See Van Gorkom, 488 A.2d at 872 (“The business judgment rule exists to protect and promote the full and free exercise of the managerial power granted to directors.” (citing Zapata Corp. v. Maldonado, 430 A.2d 779, 782 (Del. 1981)); see also United Copper Sec. Co. v. Amalgamated Copper Co., 244 U.S. 261, 263–64 (1917) (“Courts interfere seldom to control such discretion intra vires the corporation, except where the directors are guilty of misconduct equivalent to a breach of trust, or where they stand in a dual relation which prevents an unprejudiced exercise of judgment . . . .”).
business judgment rule, director negligence would have to be gross rather than ordinary negligence to result in any liability.80

In addition to the relaxed standard of care and the presumption that due care was taken in all decisionmaking, directors may also be protected from liability for duty of care violations if the corporation has chosen to adopt a charter provision limiting director liability.81 Under most state statutes, a corporation may provide in its articles of incorporation that directors shall not be liable for fiduciary violations, with certain specific exceptions, such as violations of the duty of loyalty, actions made in bad faith, and fiduciary violations that are unlawful.82

So-called “exoneration provisions” were first authorized by statute in Delaware.83 The Delaware legislature was concerned about the holding in Smith v. Van Gorkom, where the Supreme Court of Delaware held directors liable for not exercising due care in approving a merger transaction.84 Van Gorkom was seen as a judicial stretching of director liability, leaving existing and potential directors of Delaware corporations feeling very vulnerable.85 Adding to the director liability crisis was the increasing cost and, in some cases, unavailability of director and officer insurance.86 The legislature swiftly enacted a new provision to its corporate code, which allows corporations to include in the articles of incorporation

81. See James J. Hanks, Jr., Evaluating Recent State Legislation on Director and Officer Liability Limitation and Indemnification, 43 BUS. LAW. 1207, 1210 (1988).
82. See id. at 1210–12; see also Dennis R. Honabach, Smith v. Van Gorkom: Managerial Liability and Exculpatory Clauses—A Proposal to Fill the Gap of the Missing Officer Protection, 45 WASHBURN L.J. 307, 313 & nn.48–49 (2006) (discussing and listing the charter-option statutes of forty-four states).
(a) provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director: (i) For any breach of the director’s duty of loyalty to the corporation or its stockholders; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law; (iii) under § 174 of this title [(unlawful payment of dividends and unlawful stock redemption)]; or (iv) for any transaction from which the director derived an improper personal benefit. 87

All of the other states quickly followed Delaware’s lead and enacted similar exoneration statutes, 88 and many have enacted other provisions expanding the corporation’s authority to indemnify directors and officers against liability, 89 capping damages, 90 and in some instances limiting liability for all directors to willful misconduct or recklessness, without requiring the corporation to elect into limited liability in the charter. 91 The current state of the duty of care is that of a tepid constraint on director behavior. One commentator remarked that the corporate director’s duty of care “is spoken of in unusually shrunken terms.” 92

The duty of loyalty is also much less strict in the corporate setting. Unlike the trustee, who is forbidden from self-dealing and is subject to the no further inquiry rule, which makes fairness of the transaction irrelevant, 93 a director engaging in self-dealing has almost always been allowed to avoid liability by showing procedural and substantive fairness of the transaction. 94 Substantive fairness has even been dropped as a requirement in most state statutes,

93. See supra notes 32–42 and accompanying text.
which allow a director to engage in self-dealing with the corporation if the transaction is approved by a majority of disinterested directors or shareholders, or even if not so approved, if a court finds that the transaction was fair to the corporation.  

State statutes generally do not state an affirmative duty of loyalty for corporate managers but many do prohibit certain breaches of that duty. Nevertheless, the duty of loyalty, even in the more liberal corporate environment and with the recent trend of confining duties, is not limited to a checklist of violations. As Justice Cardozo stated, “Equity refuses to confine within the bounds of classified transactions its precept of a loyalty that is undivided and unselfish.”

The Delaware courts have added another aspect of the duty of loyalty: the duty to act in good faith. In the much-discussed Disney litigation involving the hiring and firing of Michael Ovitz, the court of chancery initially labeled good faith as a third fiduciary duty. Although the court acknowledged that previous Delaware decisions were unclear as to whether a separate duty existed, calling it a “fog of . . . hazy jurisprudence,” the court concluded that “the concept of intentional dereliction of duty, a conscious disregard for one’s responsibilities, is an appropriate (although not the only) standard for determining whether fiduciaries have acted in good faith.”

Shortly after the Disney court of chancery opinion was affirmed by the Delaware Supreme Court, the supreme court further clarified the role of good faith in Stone v. Ritter. The Stone court called good faith a “‘subsidiary element[,]’ i.e., a condition, ‘of the fundamental duty of loyalty.’”

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96. See Hanks, supra note 81, at 1211–12.
98. See In re Walt Disney Co. Derivative Litig., 907 A.2d 693, 755 (Del. Ch. 2005) (identifying a “good faith requirement of a corporate fiduciary” that is distinct from the duties of care and loyalty), aff’d, 906 A.2d 27 (Del. 2006).
99. Id. at 697, 745.
100. Id. at 753–55.
102. Id. (alteration in original) (quoting Guttman v. Huang, 823 A.2d 492, 506 n.34 (Del. Ch. 2003)); see also Andrew S. Gold, The New Concept of Loyalty in Corporate Law,
TOO MANY TIARAS

D. Fiduciary Duties of Managers and Owners of Unincorporated Entities

The various forms of unincorporated entities, such as family limited partnerships and limited liability companies, are extremely important when considering the ramifications of holding dual fiduciary positions because of the increasing popularity of these entity forms in estate planning and family business planning.103

1. General Partnerships. The evolution of fiduciary duties in this context began with the general partnership.104 In a classic partnership, the balance of power among participants is much closer to the horizontal contract model and farther from the vertical trust model because all parties have power over the organization and each other.105 Therefore, because the parties serve as fiduciaries to each other, and because each fiduciary also holds a beneficial interest in the enterprise (aligning the fiduciary's interest with the beneficiary's), the fiduciary duties will be less strict than those imposed on a trustee.106 However, despite the fact that each partner is subject to personal liability for actions of the other partners, a partner's fiduciary duty was traditionally considered stricter than that of a corporate director or officer.107

It was in a case involving a partnership that Judge Cardozo made his classic statement of the fiduciary duty of loyalty, which

103. See JOHN R. PRICE & SAMUEL A. DONALDSON, PRICE ON CONTEMPORARY ESTATE PLANNING § 11.1, at 11-4 (2010 ed.) (“Most commonly, the family entity takes the form of a so-called ‘family limited partnership’ (FLP), but they can be (and many times are) in the form of any limited liability entity, including the LLC and the S corporation.”); Kenneth P. Brier & Joseph B. Darby, III, Family Limited Partnerships: Decanting Family Investment Assets into New Bottles, 49 TAX LAW. 127, 128 (1995).
104. See Brier & Darby, supra note 103, at 140 (explaining that the Uniform Limited Partnership Act defined limited partnerships through reference to general partnerships).
105. See Easterbrook & Fischel, supra note 14, at 432–33.
106. See id. at 432–34 (listing various fiduciary relationships and the variations in their duties). A similar relationship, when courts have taken an even more relaxed view of the parties' fiduciary duties, is the duty owed by spouses in community property states in dealing with the community property. See Lisa R. Mahle, A Purse of Her Own: The Case Against Joint Bank Accounts, 16 TEX. J. WOMEN & L. 45, 54 (2006) (stating that California is “the only state to have given robust legal content to the business partnership analogy” to the spousal relationship); see also Alexandria Streich, Comment, Spousal Fiduciaries in the Marital Partnership: Marriage Means Business but the Sharks Do Not Have a Code of Conduct, 34 IDAHO L. REV. 367, 379 (1998).
continues to be cited regularly by the courts in all categories of fiduciary cases.\textsuperscript{108} In \textit{Meinhard v. Salmon}, two partners leased a building and subleased to shops and offices.\textsuperscript{109} Before termination of the lease, the partner managing the enterprise entered into a new lease with the property owner that did not include the other partner.\textsuperscript{110} In condemning this misappropriation of the venture’s business opportunity, Judge Cardozo stated:

Joint adventurers, like copartners, owe to one another . . . the duty of the finest loyalty. Many forms of conduct permissible in a workaday world for those acting at arm’s length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the “disintegrating erosion” of particular exceptions. Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd.\textsuperscript{111}

The common law therefore initially viewed fiduciary duties of participants in unincorporated entities as an essential part of the relationship. The Uniform Partnership Act (UPA), applicable to general partnerships,\textsuperscript{112} was introduced in 1914 and did not specifically define the scope of fiduciary duties of partners.\textsuperscript{113} Instead, it incorporated the law of agency\textsuperscript{114} and specified only that a partner was “[a]ccountable as a [f]iduciary” and “must account to the partnership for any benefit, and hold as trustee for it any profits derived by him without the consent of the other partners from any transaction connected with . . . the

\begin{thebibliography}{9}
\bibitem{108} See Hillman, \textit{supra} note 11, at 443 (acknowledging Justice Cardozo’s standard as “the controlling precedent in fiduciary duty litigation”).
\bibitem{109} Meinhard v. Salmon, 164 N.E. 545, 545–46 (N.Y. 1928).
\bibitem{110} \textit{Id.} at 546.
\bibitem{111} \textit{Id.} (citation omitted).
\bibitem{112} “General partnership” is defined in \textit{Black’s Law Dictionary} as: “A partnership in which all partners participate fully in running the business and share equally in profits and losses (though the partners’ monetary contributions may vary).” \textit{Black’s Law Dictionary} 1230 (9th ed. 2009).
\end{thebibliography}
partnership. The UPA was not revised until 1992, and the Revised Uniform Partnership Act (RUPA), in response to concerns about "galloping Meinhardism," took a very different approach to defining a partner's fiduciary duty. Section 404 limits a partner's duty of loyalty to: a duty "to account to the partnership and hold as trustee for it any property" acquired personally by the partner in connection with the partnership's business; a prohibition on dealing with the partnership "as or on behalf of a party having an interest adverse to the partnership"; and a prohibition against competing with the partnership.

RUPA further narrows the duty of loyalty by allowing for some self-dealing:

A partner does not violate a duty or obligation under this [Act] or under the partnership agreement merely because the partner's conduct furthers the partner's own interest.

A partner may lend money to and transact other business with the partnership, and as to each loan or transaction the rights and obligations of the partner are the same as those of a person who is not a partner, subject to other applicable law.

The second aspect of a partner's duty of loyalty—dealing with the partnership as someone with an adverse interest—is therefore not the broad prohibition on self-dealing that it might appear to be, since loaning money or otherwise transacting business with the partnership would arguably give the partner an interest adverse to the partnership. The RUPA comments make clear that in this area, a partner is not like a trustee:

A partner as such is not a trustee and is not held to the same standards as a trustee. Subsection (e) makes clear that a partner's conduct is not deemed to be improper merely because it serves the partner's own individual interest.

That admonition has particular application to the duty of loyalty and the obligation of good faith and fair dealing. It

115. UNIF. P'SHIP ACT § 21(1), 6 U.L.A. 194 (2001). That language was read by the courts not to limit a partner's fiduciary responsibilities to that specified duty, but rather was read as confirmation of a broad duty of loyalty. See, e.g., Meinhard, 164 N.E. at 545–46; Dickerson, supra note 69, at 114.


underscores the partner’s rights as an owner and principal in the enterprise, which must always be balanced against his duties and obligations as an agent and fiduciary. For example, a partner who, with consent, owns a shopping center may, under subsection (e), legitimately vote against a proposal by the partnership to open a competing shopping center.\(^{119}\)

The RUPA drafters therefore made specific accommodation to the fiduciary responsibility in light of the unavoidable conflict of being both fiduciary and joint owner. With respect to duty of care, RUPA states that a partner’s duty is “limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law.”\(^{120}\) Therefore, ordinary negligence of a partner will not expose her to liability, unless the partnership agreement creates a higher duty of care than the statute.\(^{121}\) The gross negligence standard for partners has been likened to the standard applied to corporate directors, which is ordinary negligence but lessened considerably by the business judgment rule.\(^{122}\)

In addition to the stated duties of loyalty and care, RUPA requires that a partner’s actions with respect to the partnership shall be consistent “with the obligation of good faith and fair dealing.”\(^{123}\) The requirement of good faith is arguably not a fiduciary duty but rather the baseline duty owed in all contractual relationships.\(^{124}\)

As to waiver, RUPA provides that the duty of loyalty cannot be entirely eliminated by the partnership agreement, but that the agreement “may identify specific types or categories of activities that do not violate the duty of loyalty, if not manifestly unreasonable,”\(^{125}\) and that all the partners, or a lesser number

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120. UNIF. P’SHP ACT § 404(c) (amended 1997), 6 U.L.A. 73, 143 (2001).
124. RESTATEMENT (SECOND) OF CONTRACTS § 265 (1981); Dibadj, supra note 8, at 461. Whether this duty of good faith is higher than the contractual duty of good faith and whether good faith is a third, separate fiduciary duty is a matter of some controversy. See Dickerson, supra note 69, at 133–36. The RUPA comments, however, specify that the duty of good faith imposed by Section 404 is the contractual duty: “The obligation of good faith and fair dealing is a contract concept, imposed on the partners because of the consensual nature of a partnership. It is not characterized, in RUPA, as a fiduciary duty arising out of the partners’ special relationship.” UNIF. P’SHP ACT § 404 cmt. 4 (amended 1997), 6 U.L.A. 145 (2001) (citation omitted).
specified in the agreement, may authorize or ratify a specific act or transaction that would be a violation of the duty of loyalty, after full disclosure of all material facts. The duty to act in good faith cannot be waived, but the partnership agreement “may prescribe the standards by which the performance of the obligation is to be measured, if the standards are not manifestly unreasonable.”

2. Limited Partnerships. General partnerships have the disadvantage of exposing all partners to personal liability, so other forms of unincorporated entities were devised that retained the pass-through taxation of a partnership but allowed for limited liability similar to corporations. The first of these was the limited partnership. A limited partnership requires at least one general partner, who has personal liability, and at least one limited partner, whose liability is limited to his or her investment in the partnership.

The first Uniform Limited Partnership Act (ULPA) was promulgated in 1916 and revised in 1976. In 1985, the Act was substantially amended, and that new version was known as the Revised Uniform Limited Partnership Act (RULPA). The Uniform Act was again amended in 2001, and that revision is commonly referred to as Re-RULPA. The most significant aspect of Re-RULPA was delinking the Limited Partnership Act from RUPA and creating a new stand-alone act. Limited partners owe no fiduciary duties to other partners or to the partnership, according to the Act,

126. Id. Note that the ability of the partners to ratify or authorize in advance certain transactions is consistent with trust beneficiaries’ ability to do the same. See UNIF. TRUST CODE § 1009 (amended 2001), 7C U.L.A. 656 (2006).
130. Id. at 989. For an overview of the limited partnership and the other unincorporated business entities discussed in this section, see id. at 993–1004. See also LARRY E. RIBSTEIN & JEFFREY M. LIPSHAW, UNINCORPORATED BUSINESS ENTITIES § 11.01 (4th ed. 2009), for additional background and history of the limited partnership.
and are free to further their own interests. Although Re-RULPA now contains its own statement of the general partners’ duties, it borrows the RUPA provisions almost word for word. The only difference between Re-RULPA’s section on fiduciary duties of general partners and RUPA’s section on partners’ fiduciary duties is the omission in Re-RULPA of the specific authorization for a partner to “lend money to and transact other business with the partnership.” RUPA therefore has a more permissive attitude towards self-dealing, which may be because of the difference in power in a limited partnership. The fiduciary standard should be higher in a limited partnership because the general partner has independent authority and the limited partner lacks management power, thus coming closer to a trustee–beneficiary relationship.

Re-RULPA also incorporates, word for word, RUPA’s gross negligence standard for a general partner’s duty of care.

3. Limited Liability Companies. Surpassing the limited partnership in current popularity is the limited liability company (LLC). The LLC’s attractiveness lies in its combination of the

139. GREGORY, supra note 128, § 264, at 438. Re-RULPA assumed that limited partnerships currently would be used in settings where the limited partners had virtually no management power:

This Act therefore targets two types of enterprises that seem largely beyond the scope of LLPs and LLCs: (i) sophisticated, manager-entrenched commercial deals whose participants commit for the long term, and (ii) estate planning arrangements (family limited partnerships). This Act accordingly assumes that, more often than not, people utilizing it will want:

- strong centralized management, strongly entrenched, and
- passive investors with little control over or right to exit the entity.

The Act’s rules, and particularly its default rules, have been designed to reflect these assumptions.

140. Compare Unif. Ltd. P’ship Act § 408(c) (amended 2001), 6A U.L.A. 439 (2008) (“A general partner’s duty of care to the limited partnership . . . is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law.”), with Unif. P’ship Act § 404(c) (amended 1997), 6 U.L.A. 143 (2001) (“A partner’s duty of care to the partnership . . . is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law.”).
141. See PRICE & DONALDSON, supra note 103, § 11.1.1, at 11-5 (“Propelled by tax and nontax considerations and considerable hype, the LLC has become the vehicle of choice.”); David L. Cohen, Theories of the Corporation and the Limited Liability Company: How Should Courts and Legislatures Articulate Rules for Piercing the Veil, Fiduciary Responsibility
best features of two entities: it offers pass-through taxation, like a partnership, and limited liability for all participants, like a corporation. The Uniform Law Commissioners responded to the surge of interest in LLCs in 1996 with the Uniform Limited Liability Company Act, which was revised in 2006. Because the LLC is somewhat of a hybrid of a corporation and a partnership, the fiduciary duties owed by owners–managers could draw from either the corporate or partnership model, and the Act chose to straddle the forms in at least one respect. Fiduciary duties under the Act depend on whether the company is managed by all members (a “member-managed limited liability company”) or is managed by a group of managers elected by members (a “manager-managed limited liability company”). In a manager-managed company, members who are not managers (like shareholders in a public corporation) owe no fiduciary duty to the other members or the company. Under the original Act, managers of a manager-managed company and all members of a member-managed company were held to exactly the same duties as a partner under RUPA. The 2006 revisions changed the


145. See Cohen, supra note 141, at 461.
147. UNIF. LTD. LIAB. CO. ACT § 409(g)(5) (amended 2006), 6B U.L.A. 489 (2008) (“A member does not have any fiduciary duty to the company or to any other member solely by reason of being a member.”). This release from duty is also identical to that granted limited partners under ULPA 2001. UNIF. LTD. P’SHP ACT § 305(a) (amended 2001), 6A U.L.A. 424 (2008) (“A limited partner does not have any fiduciary duty to the limited partnership or to any other partner solely by reason of being a limited partner.”).
148. Compare UNIF. LTD. LIAB. CO. ACT § 409, 6B U.L.A. 597–98 (2008) (“A member’s [and manager’s] duty of loyalty . . . is limited to . . . accounting to the company[,] . . . refrain[ing] from dealing with the company[,] . . . [and refrain[ing] from competing with the company[,] . . . [and a] member’s [and manager’s] duty of care . . . is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law.”), with UNIF. P’SHP ACT § 404 (amended 1997), 6 U.L.A. 143 (2001) (same, for partners and partnerships). Interestingly, the ULLCA
fiduciary duties of managers in a manager-managed LLC and members in a member-managed LLC in several important respects. First, the duty of care is simple negligence rather than gross negligence, but the business judgment rule applies. Parties may opt out of the statutory standard of care, but the standard of care cannot be completely eliminated, and the new standard of care may not be “manifestly unreasonable” and may not “authorize intentional misconduct or knowing violation of law.” As for the duty of loyalty, the new Act lists the same specific prohibitions as in RUPA, ULPA, and the original ULLCA, but does not make the list exclusive. The original approach was to “cabin” the duty of loyalty to prohibit only specified transactions, but the drafters of the new Act “decided that: (i) the ‘corral’ created by RUPA does not fit in the very complex and variegated world of LLCs; and (ii) it is impracticable to cabin all LLC-related fiduciary duties within a statutory formulation.” In addition, the new Act eliminated the confusing inconsistency of RUPA by omitting the RUPA, ULLCA, and ULPA provisions that allowed a partner to do business with and lend money to the entity.

E. Underlying Theories of Fiduciary Duty in the Business and Trust Contexts

“As law goes, fiduciary doctrine is long on generalities and short on substance.”

One critical difference between the duties of a trustee and the duties of a corporate fiduciary is the extent to which the duties may be waived. The theoretical discussions of the nature of the fiduciary duty generally offer some insight into the role of waivability of duties in both contexts. The nature of the fiduciary

picked up the RUPA language that specifically authorizes a member to make loans to and transact other business with the company. UNIF. LTD. LIAB. CO. ACT § 409(c) & cmt. (c) (amended 2006), 6B U.L.A. 597–98 (2008); UNIF. P'SHIP ACT § 404 (amended 1997), 6 U.L.A. 143 (2001). This is understandable in the member-managed LLC, which is more like a general partnership, but puzzling for manager-managed LLCs, which are more like limited partnerships.

154. Hillman, supra note 11, at 442.
principle is regularly debated by scholars, and a common theme is whether fiduciary duties are mandatory duties, required by the relationship, or only implied contract terms, which the law imposes because the parties would have included them as express terms if they would have been aware of their necessity. Under the latter theory, fiduciary rules are default rules and can be waived by express terms of the contract. Proponents of this theory, the so-called “contractarians,” argue that fiduciary duty is just a gap-filler contract term. As explained by Easterbrook and Fischel:

When the task is complex, when efforts will span a substantial time, . . . a detailed contract would be silly. When one party hires the other’s knowledge and expertise, there is not much they can write down. Instead of specific undertakings, the agent [(the manager in corporations, the trustee in the law of trusts)] assumes a duty of loyalty in pursuit of the objective and a duty of care [(prudence in the law of trusts)] in performance . . . [T]he process is contractual—because both principal and agent enter this understanding for gain . . .

. . . [A] “fiduciary” relation is a contractual one characterized by unusually high costs of specification and monitoring. The duty of loyalty replaces detailed contractual terms . . .

Under this theory, the parties to the relationship should be free to weigh the agency costs, e.g., the costs of delegating management of assets to a person other than the owner, which are lessened by fiduciary duty, against the costs of heightened liability of the fiduciary created by fiduciary duties. If there is little risk that the fiduciary will abuse the power, then the agency costs are low and the beneficiary would want to, and should be able to, waive the higher level of fiduciary duties, which are expensive.
Other theorists have objected to the contractarian approach and assert that fiduciary duties are mandatory, required by the imbalance of power in the relationship. Under this view, although the duties can perhaps be reduced, they cannot be eliminated by contract. These commentators argue that fiduciary duties are unlike contractual duties, in that they are imposed in some circumstances even if the parties would have waived or in fact attempted to waive them, in order to avoid abuse of power. Under this view, the vertical nature of fiduciary relationships, as opposed to the presumed horizontal, equal-bargaining-power relationship of contracting parties, requires an external imposition of protections.

These two positions have been discussed at length in both the trust and business fiduciary context and in the corporate fiduciary context. The contractarian approach has had a significant tangible effect on the evolution of business entity statutes addressing fiduciary duties. The evolving view of the business entity as a “nexus of contracts,” growing out of the influence of economics on business law encouraged by Ronald H. Coase’s famous article, The Nature of the Firm, gave rise to the general contractarian theory of corporations, which posits that no rules governing corporations should be mandatory, and that parties should be free to create their own contract with minimal judicial or statutory requirements. The primary justification for the contractarian view is cost: mandatory rules, particularly fiduciary duty rules, will increase the parties’ transaction costs, which will in turn be passed on to consumers. The overarching

164. DeMott, supra note 163, at 887; see also Alexander, supra note 29, at 777–78.
165. See Alexander, supra note 29, at 776–78; Melvin Aron Eisenberg, The Limits of Cognition and the Limits of Contract, 47 STAN. L. REV. 211, 249 (1995); FitzGibbon, supra note 163, at 338.
166. See Dickerson, supra note 69, at 136–40.
169. See Miller, supra note 116, at 1615–17.
170. Dickerson, supra note 144, at 453–55; Miller, supra note 116, at 1618; Ribstein, supra note 161, at 541–44.
contractarian view of business organizations embraced the contractarian view of the fiduciary principle. This view took hold in Delaware, resulting in statutes that severely limit fiduciary duties of business managers and allow for almost complete contractual waiver. The contractarian approach, as codified, applies equally to public corporations as well as closely held corporations, with some exceptions, and has also been extended to unincorporated business associations, as noted above.

The contractarian view has also been raised in the context of trustee duties, which is the strictest of fiduciary roles. It is difficult to support the notion of freedom of contract in this context, because the fiduciary principle is here intended to protect the interests of the beneficiaries, who had no part in the contract. However, John Langbein has argued that the intent of the trustor can be diluted by strict application of the duty of loyalty, and that the mandatory duty should bend in the face of contrary trustor intent.

Professor Langbein’s position has yet to make an impact on judicial decisions, but codifications of the duty of loyalty in the trust arena have to some extent cut back on the common law duty. The Uniform Trust Code (UTC), adopted in twenty-three states, codifies the duty of loyalty and changes the self-dealing rule to apply only to transactions with the actual trustee. Common law would extend the self-dealing prohibition to close affiliates of the trustee, but the UTC provides that for close-affiliate transactions, the trustee can defend the self-dealing by arguing fairness of the transaction, a defense traditionally not available for self-dealing.

171. See Miller, supra note 116, at 1615–17.
172. The oppression doctrine, discussed infra notes 221–223 and accompanying text, is one exception.
173. See supra notes 166–71 and accompanying text.
175. John H. Langbein, Questioning the Trust Law Duty of Loyalty: Sole Interest or Best Interest?, 114 YALE L.J. 929, 980–82 (2005); see also Langbein, supra note 24, at 659.
177. See supra notes 34–44 and accompanying text.
179. See Langbein, supra note 175, at 979 (arguing that the Uniform Trust Code is a departure from the common law’s sole interest rule “in favor of a standard that recognizes circumstances in which the overlap of interest may benefit the beneficiary”).
The debate rages on in the realm of business organizations. The contractarians seem to be carrying the day, in light of the current statutes, but the position is continually criticized by scholars.\textsuperscript{181} In particular, the extension of the contractarian approach to closely held business entities has been criticized, primarily based on the differences between the relationship of a publicly held corporation’s managers and its shareholders and the relationship between managers and owners of closely held entities.\textsuperscript{182} The most recent of the uniform statutes, RULLCA, showed a retreat from the strict contractarian approach,\textsuperscript{183} but was also criticized for adding the business judgment rule, thus diluting the move toward a more stringent duty.\textsuperscript{184} The trend, however, seems to be in the direction of continued loosening of the mandatory duties, and that punctilio of honor continues to retreat in the face of market forces.\textsuperscript{185} The theoretical underpinnings of statutory definitions of the duty thus demonstrate that the gap between trustee duties and those of business fiduciaries will stay wide, continuing to obscure the dual-role fiduciary’s proper course of action.

\textbf{F. Comparison of the Various Definitions of Fiduciary Duty}

It is tempting for courts faced with the dual-purpose fiduciary simply to reach for the stricter duty, assuming that is the safe choice. However, the relaxed standard for business fiduciaries is not just a result of honoring freedom of contract, but in fact protects key aspects of successful business management. To prevent a court from reaching for the deceptively simple and seemingly safe choice, it is imperative to analyze the reasons for the gaps between the two categories of duties and the purposes that fiduciary duties play in each.

The basis of general rules governing a fiduciary’s behavior is an assumption that in order to act in the beneficiary’s interest, the fiduciary must eliminate and avoid any conflicting personal


\textsuperscript{182} E.g., Sandra K. Miller, \textit{Fiduciary Duties in the LLC: Mandatory Core Duties to Protect the Interests of Others Beyond the Contracting Parties}, 46 AM. BUS. L.J. 243, 255–57 (2009) (highlighting the “asymmetries in information” and inequalities between parties to transactions involving closely held business entities).

\textsuperscript{183} See \textit{supra} notes 146–53 and accompanying text.

\textsuperscript{184} Campbell, \textit{supra} note 8, at 30, 42.

\textsuperscript{185} Dibadj, \textit{supra} note 8, at 455–56.
interests. This is in contrast to parties to a contract, who are expected to have self-interests in the transaction and are bound only by a duty of good faith not to pursue those interests unfairly. There is undoubtedly a level of self-interest with fiduciaries; however, trustees are allowed to charge fees, and corporate managers work for salaries and are likely to have personal investments in the business enterprise. The problem lies in defining how much self-interest ought to be tolerated.

The agency cost of the relationship is the lack of monitoring that would prevent the fiduciary from pursuing self-interest to an unfair degree and taking advantage of the position. To compensate for the lack of monitoring, the fiduciary principle imposes heightened duties and liabilities to work as a disincentive. For example, if a trustee is not subject to the no further inquiry rule, then a trustee may be tempted to self-deal. She might give herself a “sweetheart” deal, with the knowledge that it is likely the transaction will not come to light, and that if it did, she would only have to compensate the trust for its loss (i.e., the difference between fair price and what the trustee actually paid). The no further inquiry rule increases the extent of liability exposure, shifts the focus from making the victim whole to punishing the wrongdoer, and requires a self-dealing trustee to disgorge any profit that the trustee may have made. The increased exposure to liability acts as a monitoring substitute. Viewed with this purpose in mind, the extent of the lack of monitoring should dictate the strictness of the fiduciary duty.
Trustees generally hold the highest duty because they are not supervised by courts, and while they can be monitored by the beneficiaries, the beneficiaries are often young, incapacitated, or otherwise unsophisticated, and their source of information is the trustee. By contrast, business entity fiduciaries are subject to more scrutiny. If the entity is publicly traded, they are subject to government oversight; and if a private entity, it is likely that the beneficiaries to the fiduciary relationship are involved directly with the business.

Another difference is that, in the corporate fiduciary setting, conflicting personal interests are unavoidable because the business fiduciary will generally have a larger personal stake than the trustee, either because the fiduciary’s role is full-time employment, or because the fiduciary is personally invested in the enterprise. A trustee, on the other hand, generally is not a full-time position, and the trustee generally does not have a financial stake in the trust. The introduction of personal interests in the business fiduciary setting justifies the lessening of the duty in part because the fiduciary should have the right to protect his or her own stake in the enterprise, and in part because the fiduciary’s personal stake will cause the fiduciary to exercise care in management and thus provide some protection to the beneficiary’s interest, a manifestation of the “rising tide lifts all boats” aphorism.

Also, the trustee’s fees are usually fixed, in contrast to the business fiduciary (who is likely to receive incentive compensation), so the business fiduciary has more incentive to increase the value of the asset.

195. CA RYL A. YZENBAARD, GEORGE GLEASON BOGERT & GEORGE TAYLOR BOGERT, THE LAW OF TRUSTS AND TRUSTEES § 481, at 211–14, 238 (3d ed. 2009) (discussing the importance of the high standards for fiduciaries in relationships such as guardianships and conservatorships).


197. See Dickerson, supra note 69, at 118.

198. Victor Brudney & Robert Charles Clark, A New Look at Corporate Opportunities, 94 HARV. L. REV. 997, 1024 (1981); see also AMY MORRIS HESS, GEORGE GLEASON BOGERT & GEORGE TAYLOR BOGERT, THE LAW OF TRUSTS AND TRUSTEES § 1, at 11 (3d ed. 2007) (noting that it is only in rare cases that the beneficiary is allowed to enjoy the trust property). However, it is not uncommon for a beneficiary of the trust to also serve as trustee, particularly in family settings. Langbein, supra note 175, at 938. That situation offers its own complications.


200. See 1 RADIN, supra note 66, at 321 (“Stock options provide a frequent form of director and officer compensation.”).
Other contrasts between the trust beneficiary and the protected party in a business entity include the likelihood that a business investor is diversified and can exit the relationship easily, whereas a trust beneficiary's interest in the trust is more likely to be a greater percentage of his or her wealth and more difficult (if not impossible) to reinvest if unhappy with the trustee's performance. The number of potential enforcers of the duties also affects the level of required duty in the trust and business contexts. In a publicly held corporation, shareholders are so numerous and their percentage holdings are generally so insignificant that they lack the power and the incentive to litigate breaches of duty. This may be one explanation why the movement in the law of business entities is to dilute fiduciary duty, even in light of the recent corporate scandals. On the other hand, where there are only a few beneficiaries or a few shareholders, in the case of a closely held corporation, the stakes are higher and the relationships more likely to be personal, increasing the likelihood that the beneficiaries would be motivated to litigate.

If the difference in level of duty between a trustee and a business fiduciary is attributable only to a concern about freedom of contract and to the lower need for fiduciary penalties to control the behavior of business fiduciaries, then simply imposing the higher duty of trustee on the dual-purpose fiduciary would appear to be the obvious answer. However, the lesser duty of the business fiduciary plays an important role in enhancing the fiduciary's performance.

An overly strict enforcement of the fiduciary duty in the business setting may lead to over-cautious behavior, desirable in a trust setting but undesirable in a business setting where risks are necessary for long-term success of an enterprise. The drafters of the Model Business Corporation Act supported inclusion of exculpatory provisions so that “directors would not be

203. See Sitkoff, supra note 19, at 679 (noting that the primary beneficiary of shareholder actions is often the lawyers, due to shareholders “little incentive to reckon the costs and benefits of litigation”).
204. John A. Pearce & Ilya A. Lipin, The Duties of Directors and Officers Within the Fuzzy Zone of Insolvency, AM. BANKR. INST. L. REV. 361, 374 (2011) (“[R]ulings from Delaware, California, and Louisiana courts suggest a legal trend of limiting and eliminating the directors' and officers' duties to creditors while in the zone of insolvency.”).
205. Sitkoff, supra note 19, at 679.
discouraged from fully and freely carrying out their duties, including responsible entrepreneurial risk-taking.\textsuperscript{206} A trustee’s responsibility regarding investment of the assets is tilted toward conservation of the assets.\textsuperscript{207} The duty includes the duty to diversify,\textsuperscript{208} in order to reduce the beneficiary’s risk and perhaps in response to the concern that the trust assets may represent all or a significant portion of the beneficiary’s assets. Beyond diversification, the trustee is now allowed to take more risks than previously allowed, but only because some risk is now considered necessary to preserve value.\textsuperscript{209} The trustee is expected to follow “modern portfolio theory,” investing with an eye to the entire return.\textsuperscript{210} Under this approach, the trustee must take on some risk in order to keep the core value of the trust in pace with inflation, but must exercise caution in light of the beneficiaries’ circumstances.\textsuperscript{211}

This conservative approach would be disastrous in most business settings. The business manager must prudently protect capital sufficient for the business’s needs, but the primary concern must be the business rather than the investment of the owners and the owners’ individual risk tolerance. The justification behind the business judgment rule is that courts are not in a position to assess the reasonableness of a business decision,\textsuperscript{212} whereas courts are comfortable evaluating a trustee’s performance of the more straightforward task of maintaining a portfolio’s value.\textsuperscript{213} If a business manager were subject to the broad and indefinite fiduciary

\textsuperscript{206} Model Bus. Corp. Act § 2.02(b)(4) & cmt. 2.I (2010); see also Fairfax, supra note 86, at 449 (“[S]cholars claim that too much personal liability is quite simply bad for business because it undermines the innovation necessary for businesses to thrive.”).


\textsuperscript{208} UNIF. PRUDENT INVESTOR ACT § 3, 7B U.L.A. 29 (2006); see supra notes 61–63 and accompanying text.

\textsuperscript{209} See UNIF. PRUDENT INVESTOR ACT § 2, 7B U.L.A. 20 (2006) (providing a series of factors that should weigh in a trustee’s investment decisions “as part of an overall investment strategy having risk and return objectives reasonably suited to the trust”).

\textsuperscript{210} UNIF. PRUDENT INVESTOR ACT prefatory note, 7B U.L.A. 3 (2006); see also Jonathan R. Macey, An Introduction to Modern Financial Theory 17–18 (2d ed. 1998) (explaining that, under modern portfolio theory, “risk and return” are balanced to compensate investors appropriately “for accepting greater risks through the promise of higher returns”).

\textsuperscript{211} UNIF. PRUDENT INVESTOR ACT § 2, 7B U.L.A. 20 (2006); Uniform Prudent Investor Act Summary, supra note 207.

\textsuperscript{212} 1 Radin, supra note 66, at 35.

duties of a trustee, he would react by acting conservatively in order to best avoid liability. But that conservative behavior can ultimately damage the growth and survival of the enterprise.

Another factor to consider is that within the realm of business fiduciaries, there is a broad range of interests. A shareholder in a large publicly traded corporation has different concerns than the limited partners in a family-owned limited liability company, even though as noted above, the fiduciary duties of the managers of such enterprises do not vary significantly.\(^{214}\)

There are some settings, however, where fiduciaries of close corporations have been held to standards closer to those of trustee. The classic case of *Donahue v. Rodd Electrotype Co.*\(^{215}\) illustrates the inhibiting nature of enforcing a strict fiduciary duty in a close corporation. In *Donahue*, a minority shareholder complained when the company redeemed shares of Harry Rodd, its retiring president, director, and former controlling shareholder.\(^{216}\) The redemption resulted in Rodd's children controlling the company.\(^{217}\) The minority shareholder argued that she should have had an equivalent opportunity to redeem her shares.\(^{218}\) The court held that the majority shareholders owed a duty of “utmost good faith and loyalty” to the minority shareholders.\(^{219}\) The higher standard of *Donahue* has been diluted in ensuing years, however, replacing the heightened fiduciary duty with the tort of freeze-out and the shareholder oppression doctrine.\(^{220}\) A freeze-out theory requires proof that the majority shareholder intentionally set out to deprive the minority of all benefits of stock ownership.\(^{221}\) Shareholder oppression is primarily statutory and provides causes of action to minority shareholders against majority owners who engage in fraudulent, illegal, or oppressive conduct.\(^{222}\)

214. See *supra* Part II.E (discussing the gap between the trustee fiduciary duties and the business fiduciary duties).


216. *Id.* at 508–10.

217. *Id.* at 510.

218. *Id.* at 511.

219. *Id.* at 515 (internal quotation marks omitted).


221. *Id.* at 1720; see also, e.g., *Sugarman v. Sugarman*, 797 F.2d 3, 7–8 (1st Cir. 1986) (setting forth the test minority shareholders must meet to establish a freeze-out claim).

Commentators have lamented the application of the contractarian approach of minimal, waivable duties to the closely held organization, pointing out that the situations of vulnerable owners in those organizations are more akin to trust beneficiaries than shareholders of public corporations.\footnote{See Dibadj, supra note 8, at 461, 465–69, 474.} In this context, minority owners have a much larger personal stake in the enterprise and will often have little real bargaining power in the initial creation of waivers.\footnote{Id. at 467–68.} The variations in the business fiduciary roles further demonstrate the tension between the complete abrogation of duties under the assumption of freedom of contract and the need to retain flexibility of the managers to make key business decisions. It also illustrates that courts have been willing to fashion rules to fit the special circumstances of a small business, thus setting precedent to develop a unique approach to the dual-role fiduciary.

III. WHEN ONE PERSON ACTS IN TWO FIDUCIARY CAPACITIES

The following cases illustrate the various problems encountered in cases of a dual fiduciary: the dangers to a beneficiary when the fiduciary tries to rely on the more lax set of duties; the difficult choices a fiduciary must make to avoid liability, to the detriment of the business enterprise; and the confusion of courts when evaluating the conduct of dual fiduciaries. Not surprisingly, the level of the fiduciary’s culpability and bad faith seems to affect the standard applied by the court, but the holdings often do not present adequate rules for future cases where the fiduciary’s conduct is more or less egregious. Several of the cases, however, point the way to development of a new approach that recognizes the dual fiduciary as a distinct category and balances the interests of the beneficiaries and the business entity.

A. The Estate of Harry Winston

Harry Winston’s estate plan is an archetypal illustration of how the same conduct by a fiduciary can be analyzed very differently depending on the type of fiduciary involved. The case demonstrates the dangers of the current approach defining the two

\footnote{See Dibadj, supra note 8, at 461, 465–69, 474.} \footnote{Id. at 467–68. For example, the minority stakeholders may have received their shares as gifts. It is not uncommon for a parent to form an LLC, reducing the duties as much as statutorily possible, retain management control, and gift the equity interests to children. This can be particularly risky if the parent then turns management power over to only one of the children.
fiduciary roles separately. The categorization of a fiduciary as one or another type allows a dual fiduciary to use the lower set of duties to excuse favoring his own interests over the trust beneficiary’s.

Harry Winston was the internationally famous jeweler known for such exploits as donating the Hope Diamond to the Smithsonian (mailing it via registered mail). He also labored to smuggle diamonds out of Europe just after the outbreak of World War II, his wife helping to keep them out of the hands of the Nazis by putting diamonds in her girdle. When it came time to prepare his estate plan in 1968, Harry’s family consisted of his wife, Edna, and his two sons, Ronald and Bruce, both young adults at the time. The 1968 Will treated Bruce and Ronald equally, giving each of them $600,000 outright upon his death. The Will further provided that one-half of his common stock in Harry Winston, Inc. (HWI) would be converted to cumulative, nonvoting preferred shares and given to the Harry Winston Foundation, Inc. The remaining one-half of the common shares would be placed in trust for Edna, to the extent such a gift would qualify for the then-existing marital deduction, and upon Edna’s death the remainder of such trust was subject to Edna’s general power of appointment, and in default of Edna exercising her power of appointment, the remainder would be distributed to Harry’s then-living issue. The executors and trustees named in the Will were Gerald Schultz, a “friend and business associate,” William Rogers, a “friend and attorney,” and Bankers Trust Company. Ronald was named as an alternate to either Mr. Schultz or Mr. Rogers.

In 1971, Harry executed a First Codicil, changing the disposition of the remainder of Edna’s trust. Under the 1968

225. Burleigh, supra note 1, at 49.
226. Id.
228. Id. at 2–3.
229. Id. at 8, 11.
230. Id. at 8–10. At the time, this equaled 50% of the gross estate.
231. Id. at 10 (“[A]s she may appoint by a will, specifically referring to and exercising this power of appointment, in favor of her estate, her creditors, or the creditors of her estate, or any other appointee or appointees, in further trust or otherwise.”). A general power of appointment grants a person the right to direct distribution of certain property to anyone, including himself or herself. The Internal Revenue Code defines a general power of appointment as “a power which is exercisable in favor of the [donee], his estate, his creditors or the creditors of his estate.” I.R.C § 2041(b) (2006).
233. Id. at 12.
234. Id.
Will, when Edna died, Bruce and Ronald (assuming they were both living at Edna’s death) would have received one-half of Edna’s trust, which would have consisted of all of the common voting stock of Harry Winston, Inc. outright. The 1971 Codicil changed that to put Bruce’s share in trust. Every five years following Edna’s death, Bruce would receive one-fifth of the trust principal outright, until the last payment upon the twenty-fifth anniversary of Edna’s death. A Second Codicil was signed by Harry later in 1971, making changes relating to tax issues, and in 1972 a Third Codicil was signed, disposing of his residence and the contents of the home.

In 1975, Harry revised his Will one last time before his death. In this codicil, he gave Ronald the final say in management of the company by replacing William Rogers with Ronald as one of the three executors and trustees, and further providing that:

If at any time a dispute shall arise in respect of the administration of any trust created by this Will, I direct my trustees to take such action with respect to the matter in dispute as my son, RONALD WINSTON, while serving as trustee hereunder, shall determine; and in taking such action, I direct that all my other trustees shall be entirely free, as individuals and fiduciaries hereunder, from all responsibility or liability for any losses sustained by the trust as a consequence thereof.

The changes in his estate plan reflected Harry Winston’s perception of his sons’ abilities and interests. Harry Winston supposedly once told his sister-in-law, Lillian Winston, “I have two sons[,] . . . [o]ne is a genius and one is a moron.” Ronald Winston graduated from Harvard and worked in rocket science for a time before joining the family business in his late 20s, at the request of his father. Bruce, who is four years younger than his brother,

238. Id.
241. Id. at 1–2.
242. Wadler, supra note 2.
243. The New York Times article states that his rocket propulsion studies were at MIT. Id. But in the New York Magazine article, Nina Burleigh states that the rocket studies were at NYU. Burleigh, supra note 1, at 48.
244. Wadler, supra note 2.
dropped out of college to lead a life of “relative leisure,” although according to his lawyer, he was active in the business in the 1960s and early 1970s. Bruce has been described as “notoriously laid-back” and a “very sweet guy,” while Ronald is described as a “workaholic,” “very secretive,” and prone to “long-range thinking.”

The Winston family therefore presented a classic paradigm: a family-owned business, with one driven, hardworking child interested in carrying on the business and another child who is more of a free spirit, not interested in continuing the family’s business legacy but who remains in the parents’ good graces. Harry Winston’s solution to this estate planning dilemma was also standard: split the estate equally but put the hardworking child in charge.

Harry Winston died in 1978, and until Edna’s death in 1986, Ronald managed the business with no apparent family dissension. Edna became incapacitated shortly after Harry’s death, and her sons moved her to Florida in 1979 and were appointed co-guardians for her by a Florida court. In 1983, Bruce and Ronald as co-guardians petitioned the court for approval to transfer all of Edna’s separate assets into the trust set up for her benefit under Harry’s Will. Ronald asserted that the reason for the transfer was to save on taxes in Edna’s estate, but a very significant effect of the requested transfer fell on Bruce. Under Edna’s Will, Bruce was entitled to receive one-half of her assets outright at her death. However, his share of the trust set up under Harry’s Will was to be held in trust for up to twenty-five years following Edna’s death. The transfer therefore meant that Bruce’s share of his mother’s assets was moved to his brother’s control as his trustee. Apparently, Bruce did not understand this at the time, and in 1991,

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245. Burleigh, supra note 1, at 49.
246. Wadler, supra note 2.
247. Burleigh, supra note 1, at 49.
248. Id. at 48–49.
249. See Fox, supra note 10, at 9-11 to -12, -23 (describing placing the family business in a trust and also describing various forms of passing down a business, giving as examples: (1) putting one child in control of Forbes Magazine by leaving 51% to the oldest son Steve, and leaving the remainder of interests to the other four children; (2) and the Beretta family gun manufacturing business).
252. Id.
253. Id. at 316–17.
254. Id. at 316.
255. Id.
256. Id.
after Edna’s death, Bruce brought suit in Florida to undo the transfer, claiming that Ronald had committed fraud. The court of appeals, however, found insufficient evidence of fraud, in light of the fact that the Wills of his parents and the opportunity for independent counsel were available to Bruce, and it refused to invalidate the transaction.

After Harry’s death, the executors carried out the instructions of his Will and reorganized HWI, creating 100 shares of preferred stock and 100 shares of voting common stock. Ninety-five shares of preferred were distributed to the Harry Winston Research Foundation, which in turn donated the shares to the Genetic Research Trust, an entity “created and allegedly controlled by Ronald.” Ninety shares of common stock were placed in the trust for Edna, and the remaining shares were redeemed to pay expenses. The “preferred stock [was] entitled to a guaranteed annual dividend of . . . $332,500.” Payment of this dividend was at the discretion of HWI management, but the common stock could not receive a dividend until all accrued but unpaid dividends owed on the preferred were paid.

Until Edna’s death in 1986, the ratio of preferred to common stock remained constant—ninety-five shares of preferred to ninety shares of common, so the equity position of the two types of stock was essentially the same. However, after Edna’s death, the trust started redeeming common shares to pay Edna’s estate taxes and expenses. By 1990, the trust

257. Id. at 317.

258. See id. at 320 (“By our reversal, we neither condone nor condemn Ronald’s actions. Ronald urges us to exonerate him and find no fraud existed as a matter of law, but it is unnecessary for the resolution of this appeal to reweigh the evidence to determine whether Ronald acted as the concerned, dutiful son and brother with intent to maximize the tax benefits for both his brother and himself or as a knave and scoundrel with intent to dupe Bruce and maximize his parents’ legacies for himself. We reverse because, as a matter of law, no extrinsic fraud has been demonstrated . . . .”). The Florida litigation resulted in discipline by the Florida Bar of one of Bruce’s lawyers, Edward H. Wohl, for his participation in paying a consulting fee to a former employee of the Winston family business who was a fact witness in the proceeding. Florida Bar v. Wohl, 842 So. 2d 811, 814 (Fla. 2003). David Boies and Bob Silver were the trial attorneys in the Florida litigation but only Mr. Wohl was a member of the Florida Bar and subject to discipline there. See id. at 812–13.


260. Id.

261. Id.

262. Id.

263. Id.

264. Id.
owned only seventeen shares of stock, dropping the equity position of the common from 49% (90/185) to 15% (17/112).

The corporation had never paid dividends to the common shareholders. Ronald argued that the lack of dividends was due to a lack of profitability of the company, and in any event dividends were impossible, because the accrued but unpaid dividends owed to the preferred stock would have to be paid first, and then any further dividend paid would have to pay a proportionate share to the preferred shares. Bruce was therefore receiving no income from his ownership in the company. Bruce had been employed by the company during Edna’s lifetime and had been receiving a salary, but Ronald had subsequently fired him. Ronald, however, was being paid to run the company; his compensation increased from $248,000 in 1979 to $1,138,000 in 1990.

Ronald then decided, over the objections of Bruce and the other trustees, to distribute the stock from Edna’s trust as follows: Ronald received half the stock, Bruce received 10% of the stock outright (reflecting his right to a one-fifth distribution) and the remaining 40% went to the trust for Bruce’s benefit. Ronald then had HWI and Bruce’s total interest appraised, using a liquidation value as opposed to the value if the company was sold as an ongoing business, and asked for court approval of a sale to him of all of Bruce’s interests for $4.5 million. The price was based on the appraisals, but the appraisal of Bruce’s one-half interest set the value of that interest at just a little more than a third of the total liquidation value. Presumably Bruce’s interest was discounted for marketability and control limitations. The steps taken by Ronald had therefore made Bruce’s holdings worthless as long as he or the trust owned them, and thus deeply discounted the value to Ronald of his holdings in the event of a buyout.

265. Id. at 1001–02.
266. Id. at 1002.
267. Id. at 1002–03.
268. Id. at 1003.
269. Id. at 1006–07.
270. Id. at 1002.
271. Id. at 1001.
272. Id. at 1002.
273. See id. (describing how the appraiser valued the total stock at $12 million, but valued Bruce’s one-half share at $4.5 million).
274. Id. at 1003.
This scenario was a classic “squeeze-out.”[^275] A squeeze-out usually occurs in a closely held corporation where the shareholders work for the company and no dividends are paid.[^276] The majority shareholder can remove a minority shareholder from the board, terminate the minority shareholder’s employment with the company, and continue the existing practice of not paying dividends, thus cutting off the minority shareholder’s income from the company.[^277] In this typical scenario, the terminated minority shareholder can get relief, depending on the particular facts of the case and the approach taken by the court, and such relief is usually in the form of a cash-out at fair market value of the minority shareholder’s interest in the company.[^278] Here, Ronald held only 50% of the shares, but his voting power over the trust’s shares gave him the same power to freeze out Bruce as the extra 1% ownership would have given.[^279] There is a recognized fiduciary duty owed by a majority shareholder to a minority shareholder that was not applicable here because the facts were slightly different, but that fiduciary duty presents another model of analysis in reviewing the behavior of someone in Ronald’s position.[^280]

Both Bruce and the other trustees objected to Ronald’s actions.[^281] The trustees objected to the distribution of stock to Ronald and Bruce from Edna’s marital trust, concerned that

[^275]: See Douglas K. Moll, Shareholder Oppression and “Fair Value”: Of Discounts, Dates, and Dastardly Deeds in the Close Corporation, 54 Duke L.J. 293, 301 (2004) (internal quotation marks omitted) (explaining that a “squeeze-out” occurs when a majority shareholder is able to act against the minority shareholder’s interests).

[^276]: See id. at 300–02.


[^278]: Oesterle, supra note 277, at 885–86.

[^279]: In re Winston, 631 N.Y.S.2d at 1000 (explaining that Ronald could overrule the majority decision of the trustees).

[^280]: Donahue v. Rodd Electrotype Co., 328 N.E.2d 505, 515–17 (Mass. 1975); see Paula J. Dalley, The Misguided Doctrine of Stockholder Fiduciary Duties, 33 Hofstra L. Rev. 175, 177 (2004) (noting two legal principles which have supported the application of fiduciary duties in the shareholder context).

[^281]: In re Winston, 631 N.Y.S.2d at 1001.
there would not be sufficient assets available to pay remaining fees and expenses in settling the Edna Trust. Bruce objected to the sale of his interest to Ronald based on the liquidation value appraisal. Both Bruce’s appraiser and the court’s appraiser found that the value based on a sale was at least five times higher than a liquidation value and that therefore a liquidation value was an inappropriate benchmark. The question before the court was whether Ronald’s actions were such an abuse of fiduciary duty that he should lose his veto power granted to him in his father’s Will.

Ronald defended his actions on the grounds that his father’s primary objective was preserving the company and Ronald’s continuing management of it, and that everything he had done was either necessary to carry out this purpose or a consequence foreseeable by Harry. The reviewing court found, however, that while it agreed that Harry wanted Ronald to continue at the helm of the business,

for Ronald to conclude from these facts that Harry intended to vest absolute control of the family enterprise in him for the balance of his career and to subordinate Bruce’s inheritance to this alleged dominant and paramount intention, even at the expense of depriving Bruce of the benefit and value of his “equal share” of the family fortune, is simply not supported by a reasonable construction and interpretation of the Will.

The court went on to note that if Harry intended to disinherit Bruce, there were easier ways of doing it. The court further concluded that the combination of the creation of preferred stock that was donated to the Foundation (which was according to the court, “a brilliant estate planning device”) and the redemption of a large portion of the common stock to pay Edna’s estate taxes (perhaps not so brilliant) so decimated...

282.  *Id.* The trustees claimed that the distribution of stock was self-motivated and an abuse of Ronald’s veto power. *Id.*
283.  *Id.* at 1002.
284.  *Id.*
285.  *Id.* at 1003.
286.  *Id.* at 1004–05.
287.  *Id.* at 1005.
288.  *Id.*
289.  *Id.* at 1007.
290.  Presumably, the trustees could have foreseen the estate tax liability but no steps seem to have been taken to ameliorate the effects of such a large redemption, such as paying the tax over an extended period of time under section 6166 of the Internal Revenue Code. See *I.R.C.* § 6166 (2006 & Supp. IV 2011). Without further facts, it is impossible to tell whether the shrinking of the common stock down to 15% of the company...
Bruce’s one-half interest in the common stock that the only way he could benefit from ownership was a sale of the business at its going-concern value, and that the trust had to be distributed in a manner consistent with Harry’s clear intent that Ronald and Bruce benefit equally. 291 The court ordered the stock returned to the Edna Trust and removed Ronald’s veto power, holding that Ronald had an “irreconcilable conflict” because of his status as trustee, beneficiary, officer, and director of the corporations; trustee of the Genetic Research Trust; and owner of the preferred shares. 292 Ultimately, the case between the brothers was resolved when, in 2000, the court approved sale of Bruce’s interests to Ronald and a group of investors for $54.1 million. 293

Ronald’s extreme actions caused the court to dismantle the management scheme that Harry Winston had created. Ronald excused the steps he took, which made Bruce’s present interests in the company virtually worthless, on the grounds that they were consistent with a corporate fiduciary’s duties. However, he arguably breached even those lower duties, which acknowledge a controlling party’s duty to minority owners. The court’s holding, however, relied on Ronald’s duties as trustee. 294 It reasoned that the various roles Ronald held created an irreconcilable conflict, implying that Harry Winston’s plan was structurally flawed and would have failed even if Ronald had been more protective of Bruce’s interests. 295 Arguably, Ronald’s limitation of Bruce’s interest pushed the court to emphasize the stricter role, but the two separate definitions of the fiduciary roles can cause courts to question whether it is ever permissible to serve as both. Family business owners in Harry Winston’s position commonly desire this structure of family ownership and control, so a new category that protects both beneficiaries and the business entity is necessary.

**B. Other Cases**

The case of *Rosencrans v. Fry* presents an interesting contrast to *Estate of Winston*. In *Rosencrans*, the testator owned...
close to 50% of a closely held company, with the remaining interests held by approximately fifty investors. The testator's Will left his stock in the company in trust, naming as co-trustees his wife and William Fry, a long-term employee who had been running the company since the testator had become less involved. The testator's wife was the income beneficiary of the trust, with the remainder of the trust to go to two nephews at her death. The Will also gave to "my friend, William M. Fry, the right to purchase any or all of said stock at its par value of $25.00 per share." Fry was elected president of the company, as requested in the Will, and also served on the board of directors. The book value of the shares at the time the Will was signed was over $50 a share. The testator died in 1944, and in 1946, Mr. Fry tried to exercise the option to buy the shares, but the widow became so upset he dropped the issue. In 1949, he stated his intention to exercise the option, and the widow took the position that he could not exercise the option during her lifetime.

Litigation ensued, and after a judge had entered an oral determination in favor of Mr. Fry's right to purchase the shares, but before a written judgment was entered, the widow and the two nephews, who were on the board of directors, voted large cash dividends and stock dividends of 50% and 300% be paid to existing shareholders. Mr. Fry and the other director voted against the dividends. Action on the dividends was enjoined and ultimately invalidated. Once the widow lost on the question of the enforceability of the option, she asserted a claim that Mr. Fry had breached his fiduciary duty as trustee, claiming that he should have voted for larger dividends, in the best interest of the income beneficiary, and that his option price should be increased to reflect the improperly undistributed

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297. Id. at 163, 167.
298. Id. at 163.
299. Id.
300. Id. at 166.
301. Id. at 167.
302. Id. at 163–64, 168.
303. Id. at 164.
304. Id. at 164–65. The stock dividends were issued because the widow believed that Mr. Fry's option to purchase would extend only to the original shares and not the shares issued pursuant to the stock dividend, which the court in dicta indicated was incorrect. Id. at 169.
305. Id. at 164.
306. Id. at 165.
earnings. In addition “[t]o these potentially divergent obligations, the testator added the complicating factor of an option in Fry to purchase at a fixed price, unhinged to the true worth of the shares.” The court found it relevant that the testator had created the conflict and apparently had confidence that Fry would act fairly in his dual fiduciary roles, even in light of the personal interest of the option added in. Also important to the court was the fact that the widow was also a co-trustee and on the board, as well as a beneficiary of the trust, and approved all actions taken that she was now claiming were a breach of Fry’s fiduciary duty. The pattern of retaining earnings rather than distributing all earnings as dividends was also not one of Fry’s creations; it had begun during the testator’s lifetime, and the testator had approved of the expansion program carried out after his death that required retention of earnings.

What is most significant about the Rosencrans decision is the court’s resolution of the conflict between the fiduciary duty of trustee and corporate manager. It noted that a trustee holding stock must vote such stock in a way to promote the beneficiaries’ best interests, but this “principle does not embrace a duty to advance the interest of a beneficiary at the expense of the corporation and other outstanding stockholders’ interests.” In a case of a dual fiduciary acting reasonably, the court implicitly recognized a hybrid set of duties.

In Bartlett v. Dumaine, the New Hampshire Supreme Court analyzed the duties of trustees in a setting very similar to the Winston Trust, but with very different results. In that case, Frederic Dumaine Sr. created the family’s business, the Amoskeag Company, and during his lifetime created the Dumaines Trust for the benefit of his children and grandchildren. In addition to the Dumaines Trust, Frederic Dumaine Sr. also established the Dexter Trust, which was for the benefit of his son Buck for life, with the remainder to be

307. Id.
308. Id. at 166.
309. Id.
310. Id. at 167.
311. Id. at 166–67.
312. Id. at 167.
313. Id. at 167–68.
distributed to the Dumaines Trust upon the death of the survivor of Buck and his father.\textsuperscript{315} The trusts were funded primarily with company stock, and according to the court, the elder Dumaine and his son Buck dominated the company and the trusts, and persons on the payroll of the company also generally managed the trust.\textsuperscript{316} After the death of the father, several of Buck's siblings became unsatisfied with their lack of control (and their brother's exclusive control) over the family trusts and the company, and they sought an accounting of the Dexter Trust, on the theory that, as beneficiaries of the Dumaines Trust, which in turn was the remainder beneficiary of the Dexter Trust, they had a right to know the activity in the Dexter Trust.\textsuperscript{317} In addition, they alleged various breaches of fiduciary duty on the part of trustees who also benefited as employees of the company.\textsuperscript{318}

There were two major differences between the Dumaine trusts and the Winston Trust. First, the trusts were set up during the elder Dumaine's lifetime, rather than at his death, as Harry Winston had done.\textsuperscript{319} This difference is significant because the court in \textit{Dumaine} focused on how the elder Dumaine ran the trust and the company as an integrated enterprise,\textsuperscript{320} indicating "that the settlor intended the trustees of Dumaines, within their discretion, to take business risks with trust funds in concert with the Amoskeag Company,"\textsuperscript{321} and that the prudent person

\begin{itemize}
\item \textsuperscript{315} \textit{Id.} In addition to the Dumaines Trust and the Dexter Trust, there were seven "satellite trusts," one for each of Mr. Dumaine's seven children. Each child was the income beneficiary of a satellite trust, with the remainder of the trust paid to the Dumaines Trust on the child's death. \textit{Id.}
\item \textsuperscript{316} \textit{Id.} at 5–6, 13.
\item \textsuperscript{317} \textit{Id.} at 6, 14.
\item \textsuperscript{318} The specific allegations of fiduciary breaches were: (1) a $4 million unsecured loan from the trust to one of the company's subsidiaries; (2) the purchase of a yacht from a subsidiary by a trustee who was also a company officer, and an interest-free loan from the company to the same company officer as well as a very favorable employment contract with the officer; (3) payment of over $1 million in management fees from the trust to the company; and (4) the conflicts of interest inherent in several trustees also holding positions in the company. \textit{Id.} at 6–13.
\item \textsuperscript{319} \textit{Id.} at 5; \textit{cf.} Will of Harry Winston, \textit{supra} note 227, at 8–11.
\item \textsuperscript{320} \textit{Bartlett}, 523 A.2d at 8. The court did not discuss the potential impropiety of Mr. Dumaine Sr.'s actions with regard to the trust because all beneficial interests were held by his children and grandchildren, and yet trust assets seemed available to invest in the company's various enterprises. For example, the report of the master presiding over the hearing found that the trust had "features of both a trust and a corporation," and that the general intent of the settlor was to give the trustees "absolute control of trust property and trust business." \textit{Id.} However, the beneficiaries must have some rights to enforce the trustees' duties towards them or there is no trust. \textsc{Restatement (Second) of Trusts} \S\ 25 (1959) ("No trust is created unless the settlor manifests an intention to impose enforceable duties.").
\item \textsuperscript{321} \textit{Bartlett}, 523 A.2d at 8.
\end{itemize}
standard of investment normally imposed on trustees did not therefore apply. The court, in analyzing the propriety of the trustees’ actions, noted that this was not a “normal” trust, and the conflicts of interest were “inherent in the declared scheme of the settlor.” Such inherent conflicts were present in the scheme that Harry Winston’s estate plan contemplated, but the settlor’s intent to allow such conflicts in Dumaine was ratified by the settlor’s own participation in that scheme during his lifetime.

The second difference was that the children in Dumaine could not point to specific damages such as those in the Winston case. The conflicts of interest had not resulted in any significant damage; for example, the unsecured loan of $4 million made by the trust to a company subsidiary that was in financial trouble was in fact repaid. This may have contributed to the court’s remarkably relaxed standard in judging the trustees’ actions.

The courts in Rosencrans and Bartlett both acknowledged an adjustment in a trustee’s strict duties to accommodate the business entity’s interest. In Perry v. Perry, however, another case where the trustees’ alleged breaches caused no great harm, the court applied the lower corporate fiduciary standard. A grandson of the trustor challenged the actions of his uncles as trustees and directors of the family company whose stock was owned by the trust.

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322. Id. at 7–8; see, e.g., RESTATEMENT (THIRD) OF TRUSTS: PRUDENT INVESTOR RULE § 227(a) (1992) (“The trustee is under a duty to the beneficiaries to invest and manage the funds of the trust as a prudent investor would, in light of the purposes, terms, distribution requirements, and other circumstances of the trust. This standard requires the exercise of reasonable care, skill, and caution, and is to be applied to Investments not in isolation but in the context of the trust portfolio and as a part of an overall investment strategy, which should incorporate risk and return objectives reasonably suitable to the trust.”) (statement of the more modern “prudent investor” standard); RESTATEMENT (SECOND) OF TRUSTS § 227(a) (1959) (“In making investments of trust funds the trustee is under a duty to the beneficiary in the absence of provisions in the terms of the trust or of a statute otherwise providing, to make such investments and only such investments as a prudent man would make of his own property having in view the preservation of the estate and the amount and regularity of the income to be derived.”) (traditional prudent person investment rule).

323. Bartlett, 523 A.2d at 13 (internal quotation marks omitted).

324. Id. at 5–6.

325. Id. at 15–16.

326. Id. at 7.

327. See Melanie B. Leslie, Common Law, Common Sense: Fiduciary Standards and Trustee Identity, 27 CARDOZO L. REV. 2713, 2748 & n.104 (2006) (citing Bartlett v. Dumaine as support for the point that although there is a general perception that courts enforce exculpatory clauses in trust agreements, upon review of the cases courts in fact only enforce in limited circumstances showing no unfairness, or in instances where the trustee was not a professional).


329. Id. at 99–100.
of the trust and company management (including periods during the trustor's lifetime) was replete with self-dealing and conflicts, such as no-interest loans from the company to the trustees–directors, business dealings between the company and businesses owned directly by trustees–directors that were very profitable to the trustees–directors owning the separate business, and similar transactions. However, the court found that the transactions had not caused significant damage to the trust and that there was no actual fraud or bad faith. The court expressly applied the lesser standard of conduct of directors, rather than trustees, to the trustees–directors, stating that “[t]here is no basis on the findings for disregarding the corporate entity in determining the obligations of the officers of the corporation who were also trustees.” Clearly, if the stricter trustee standards had been applied, including the no further inquiry rule, the trustees would have been answerable to the complaining beneficiary. The finding of no significant damage made it easier for the court to ignore the standard duties of trustee, just as in cases of egregious misconduct the court can easily punish the fiduciary by applying the stricter standard. The holding in *Perry* leaves beneficiaries of other trusts vulnerable, however, because dual fiduciaries will be able to rely on the lower standard, and the beneficiaries have lost the presumptions of bad faith in any case of trust self-dealing.

In *Copley v. Copley*, the court found no violations of fiduciary duty by the trustees, but the holding was based on an exception to the trustee standard of no self-dealing rather than an

330. *Id.* at 100–01. In contrast, the grandson borrowed funds from the company and was charged 4% annual interest. *Id.* at 101.

331. *See id.* at 103 (“But there is no basis for concluding that there was more than an unintentional disregard of the legal requirements or of the necessity, even in a family corporation, for formal action to record the proper basis, if it existed, including equitable offsets, of action taken in respect of corporate funds and rights.”).

332. *Id.*

333. *See supra* notes 38–42 and accompanying text (explaining that under the stricter no inquiry rule, a trustee is liable for any self-dealing, whether fair or not). Another influencing factor may have been the possible characterization of the complaining beneficiary as a disgruntled former employee: he had worked at one of his uncle’s separate business but had been fired “after twice using a company automobile for personal use contrary to orders and proving unsatisfactory in the lumber shed.” *Perry*, 160 N.E.2d at 102.

334. *Perry*, 160 N.E.2d at 103; *see Rosencrans v. Fry*, 91 A.2d 162, 167–68 (N.J. Super. Ct. Ch. Div. 1952), aff’d 95 A.2d 905 (N.J. 1953) (holding that when voting stock, “fiduciaries are under a duty to vote in such a way as to promote the interests of the beneficiaries,” but noting that adjustments to the general rule should be made when such a vote would be at the expense of the corporation or other shareholders).

application of the less stringent corporate standard.\textsuperscript{336} There, the surviving spouse was trustee of two trusts, a marital trust for her sole benefit and a nonmarital trust for the benefit of the trustor’s three children as well as the surviving spouse, who was not the mother of the decedent’s children.\textsuperscript{337} The trusts were funded primarily with stock in the decedent’s closely held business.\textsuperscript{338} The children alleged that the spouse breached her fiduciary duty by redeeming stock in the company held by the nonmarital trust at a price that was below the stock’s actual value.\textsuperscript{339} The redemption was necessary to raise cash to pay the estate tax liability.\textsuperscript{340} After her husband’s death, the surviving spouse took over management of the company as chair of the board of directors and as chief executive officer, so she was serving both the corporate and trustee roles, but her actions in redeeming the stock were clearly within her trustee duties and the court judged them under trustee standards.\textsuperscript{341} However, the court focused on the decedent’s intent, and the fact that the trust allowed the redemption, that such redemption was contemplated by the decedent, and that he had created the conflict of interest by putting his spouse in position as trustee of the nonmarital trust and beneficiary of the marital trust.\textsuperscript{342} Based on those facts, the court concluded that the decedent had authorized self-dealing, and therefore could not be held to the common law prohibition against self-dealing.\textsuperscript{343} The court nevertheless held that the redeemed shares were undervalued, and upheld an award adjusting the percentage of shares held by the marital and nonmarital trusts.\textsuperscript{344} However, the breach was essentially treated as a breach of the duty of care, requiring a corrective remedy but without the necessary punitive measures when there is a breach of loyalty.\textsuperscript{345} What is notable about the opinion is the trial court’s recognition of the

\textsuperscript{337} Id. at 848–50.
\textsuperscript{338} Id. at 849–50.
\textsuperscript{339} Id. at 847–48.
\textsuperscript{340} Id. at 853.
\textsuperscript{341} Id. at 864, 866.
\textsuperscript{342} Id. at 853, 857.
\textsuperscript{343} Id. at 862.
\textsuperscript{344} Id. at 864.
\textsuperscript{345} See Cooter & Freedman, supra note 13, at 1051–52, 1059–60 (discussing how sanctions for breaches of fiduciary duties can range from corrective to punitive). For example, the court reversed the trial court orders denying fees and costs to the trustees and removing the trustees. Copley, 178 Cal. Rptr. at 866–73.
trustor’s choices of trustee as an implicit waiver of the self-dealing prohibition, even while finding that the trustees had made an error.

In Johnson v. Witkowski, the court begins its opinion with a telling paragraph: “The situation presented by this case brings to mind the scenes in old movies in which a ship is sinking and someone is heard to yell, ‘Man the lifeboats, women and children first!’ In those movies, the captain usually went down with the ship.”

The case involves complex facts and fiduciaries who were clearly abusing their position. The two defendants in this case were trustees of trusts holding a majority interest in a closely held corporation, Johnson Corrugated, and were also officers, directors, and minority shareholders of the corporation. The defendants started a business that was to supply materials to Johnson Corrugated’s competitors. Financing for the venture was secured with personal guaranties from the defendants. The defendants apparently became concerned about conflicts with Johnson Corrugated and brought the company in as a 25% shareholder in the new venture. When the new company ran into financial trouble and needed additional financing, the new financial arrangements required an unlimited guaranty from Johnson Corrugated. Things did not improve, so the defendants removed the trust beneficiary’s brother from the board of directors of Johnson Corrugated and arranged a sale of assets of the sinking new company to a newly formed subsidiary of Johnson Corrugated. The new subsidiary would assume all secured liabilities of the failing venture. The sale was financed by a bank that required Johnson Corrugated to give an unlimited guaranty, but this time the defendants did not give personal guaranties. The defendants thus were released from significant liability under the original personal guaranties.

The Johnson court had interesting observations about the problem of multiple fiduciary roles. “Wearing more than one

347. Id.
348. Id. at 516.
349. Id.
350. Id. at 516–17.
351. Id. at 517.
352. Id. at 516–18.
353. Id. at 517.
354. Id. at 518.
355. Id. at 517–18.
hat—here, at least three—requires a fiduciary to be very nimble as well as most prudent. While the fiduciary may purport to wear one hat at a particular moment, in truth, all hats are worn together at all times. In judging the defendants’ actions, the court appeared to find a breach of both their corporate and trustee fiduciary duties. In responding to a claim of protection under the business judgment rule, the court, rather than rejecting it as inapplicable where duties of a trustee are owed, held that it was inapplicable in the corporate setting where, as here, the directors are personally interested in the transaction. The court also notably found that the trust provisions providing wide discretion to manage the trust and the corporation, and the fact that the trustor “obviously contemplates the conflicts present in the identity of the directors, officers, trustees, and shareholders,” were not sufficient to constitute a waiver of self-dealing.

The influential Delaware court addressed the dual-acting fiduciary in Stegemeier v. Magness. The decedent’s estate consisted of undeveloped real property and 83% of a construction company that was in financial difficulty. The Will provided for a gift in trust to the surviving spouse and a residuary trust for the benefit of the surviving widow for life, remainder to his children (three of whom were not the children of the widow). The widow was also named as co-executor of the estate, together with a lawyer, and the decedent’s brother, who owned the remaining 17% of the construction company, was named as trustee of the trusts. The estate attempted to sell the real estate or obtain financing for the construction company to develop the real estate but was unsuccessful at both. In order to get financing to develop the real estate, the widow and the trustee individually formed a new, debt-free corporation. The estate (through the co-executors, the widow and the lawyer) sold the land to the new corporation, securing the purchase price with

356. Id. at 518.
357. Id. at 521.
358. Id. at 522.
359. Id. at 522–23; see supra note 327 (discussing Professor Melanie Leslie’s observation that trustee exculpatory clauses are only enforced by courts in certain categories of cases).
361. Id. at 559–60.
362. Id. at 559.
363. Id. at 559–60.
364. Id. at 560.
365. Id.
a mortgage, and so the land was never placed into the trust. The new corporation developed and sold the property. Two of the stepdaughters who were remainder beneficiaries sued, claiming that the sale of the land to the new corporation was a breach of the fiduciary duties of the co-executors and of the trustee. The lower court held in favor of the defendant fiduciaries, finding that the remaindermen did not have standing because any profits from the development and sale of the land would have been trust income and the widow was the sole income beneficiary. Furthermore, the lower court held that the fiduciaries did not engage in self-dealing, using its interpretation of the corporate, rather than trustee, standard of self-dealing. The lower court had dismissed the claim of self-dealing against the lawyer co-executor, since he had no other interest in the transactions, and found that in order for the actions of the brother trustee and the widow to be considered self-dealing, the relevant factor was not whether they had a personal interest in the transaction but whether either of them could have alone caused the sale, without consent from anyone else. This is a broad reading of the corporate standard, which allows self-dealing of a director if a majority of disinterested directors approve the transaction. In this case, it was enough for the trial court that there was necessary participation by just one uninterested person, the lawyer co-executor.

The Delaware Supreme Court disagreed with the lower court and held that the trust standard should apply. The only reason given by the court for this selection is that the decedent chose the form of a trust to hold his assets. Interestingly, the court did not consider the inherent conflicts of interest created by the decedent's choices in his estate plan, a factor considered critical by other courts. See Copley v. Copley, 178 Cal. Rptr. 842, 857 (Cal. Ct. App. 1981) (noting that there is an inherent conflict in the trustor's appointment of a single individual to serve as both administratrix and co-trustee); Bartlett v. Dumaine, 523 A.2d 1, 13 (N.H. 1986) (finding that an inherent conflict of interest existed in the appointment of an employee to both trust and corporate fiduciary positions).
despite the various exceptions that have been created under the trust standard, because the underlying purpose of the absolute prohibition—to prevent fraud that would otherwise be difficult to detect, and to relieve “trustees from any possible conflict between duty and self interest,”—would not be served by such a relaxation of the standard. Under trust law principles, it was clear that the fiduciaries’ actions constituted self-dealing, and the corporate safe harbor of establishing fairness of the transaction was no longer available to them. The fiduciaries argued necessity as a justification for the sale because of the difficulty in obtaining financing to develop and sell the property. Although that may be true, the court held that the fiduciaries still had to obtain advance approval of the beneficiaries or of a court.

Although the court was harsh in its application of the standard, the remedy was closer to the result under the corporate standard. Because the lots had already been sold to third parties, the court agreed that the beneficiaries were entitled to the profits received by the fiduciaries as a result of the sale. However, the court held that because the new corporation had made significant improvements to the property before selling it, including building houses on the lots, the profit on sale of the property was due to the new corporation’s efforts. Therefore, the trust was entitled only to the difference between the fair market value of the land and the price paid by the new corporation. The case was remanded because the trial court placed the burden of proving

376. Stegemeier, 728 A.2d at 562–65; see supra notes 29–31 and accompanying text (noting that due to the lack of supervision and monitoring of trustees, fraud might be difficult to detect).

377. Stegemeier, 728 A.2d at 564 (quoting Downs v. Rickards, 4 Del. Ch. 416, 430 (Del. Ch. 1872)).

378. See Stegemeier, 728 A.2d at 565 (noting that the principles behind trust law serve more than just fairness—the minimal requirement of the relaxed standard).

379. Id. at 562–63. The trial court had made a finding that the price paid for the land was fair, and thus would have protected them under the corporate standard set forth in the Delaware statute. Id. at 561–62; Del. Code Ann. tit. 8, § 144 (2011). However, the burden of proving the adequacy of the purchase price was put on the beneficiaries by the trial court, whereas the burden under the state statute would be on the interested director. Stegemeier, 728 A.2d at 566, 568; Del. Code Ann. tit. 8, § 144 (2011); see Keenan v. Eshleman, 234 A.2d 904, 908 (Del. 1938) (finding that the interested party has the burden of proving fairness where an interested transaction occurs involving multiple corporate duties).

380. Stegemeier, 728 A.2d at 565.

381. Id.

382. Id. at 565–66. This is consistent with the general rule. See 3 Scott, Fratcher & Ascher, supra note 25, § 17.2, at 1077–79 (noting that breach results in voiding the transaction, or awards costs and profits to the plaintiff).


384. Id. at 566.
the inadequacy of the purchase price on the beneficiaries after it found no self-dealing, and the beneficiaries were therefore left with a duty of care allegation (i.e., charging that the price paid to the trust was insufficient). Since the supreme court found there was self-dealing, the fiduciaries had to prove no damage by proving the fairness of the price. Therefore, the fiduciaries were able to defend the transaction on remand on the basis of fairness of purchase price, which normally is a defense only in the corporate context. Thus, even though the court held the fiduciaries liable under the legal rules, its application of the appropriate remedy switched to the more lenient corporate standard. The court should have analyzed it as a misappropriation of a trust opportunity and required the fiduciaries to disgorge all profits, less any out of pocket expenses.

The cases generally illustrate the courts’ confusion as to which standard to apply, and their apparent resolution of the issue by first determining the extent of the harm complained of. The opinions do give some precedent for considering the design of the plan, and the choice of putting one person in the two roles, as an indication of the trustor’s intent to waive certain fiduciary duties. However, a dual-role fiduciary reading these decisions would receive little if any guidance as to the extent of the fiduciary duties applicable to his or her situation.

IV. A NEW STANDARD FOR THE DUAL-ROLE FIDUCIARY

While Bruce Winston may have had good grounds to object to his brother’s administration of his trust and the company, the harder question is the one faced by the person who finds himself in

385. Id. at 566–67.
386. Id.
387. Id. The defendants successfully carried the burden of proving a fair purchase price on remand and were therefore not liable to the beneficiaries. Stegemeier v. Magness, No. Civ. A. 12845, 1999 WL 1083874, at *7, (Del. Ch. Nov. 23, 1999), aff’d 748 A.2d 408 (Del. 2000).
388. See Del. Code Ann. tit. 8, § 144(a)(3) (2011) (finding interested transactions not automatically voidable where they are fair at the time the transaction takes place); 3 Scott, Fratcher & Ascher, supra note 25, § 17.2.1.1, at 1089–91 (“In both England and the United States a trustee ordinarily violates the duty of loyalty by purchasing trust property in his or her individual capacity without the beneficiaries’ consent, even if the transaction is in all other respects unobjectionable. . . . Of course, if the trustee has already paid a fair price, the beneficiaries may affirm the sale, as they may well wish to do if the value of the property has fallen, for the sale is not void but voidable. In other words, when a trustee purchases trust property without the beneficiaries’ consent, the trustee cannot profit from an increase in the value of the property but must bear the loss on a decline.”).
389. See 3 Scott, Fratcher & Ascher, supra note 25, § 17.2, at 1078–79 (reasoning that trustees who place their own interests over those of the trust are generally liable for loss and for any profits).
this dual role, or the question faced by the trustor and business owner trying to devise a workable plan. Should the trustee–business manager conduct the business in a manner that takes the trust beneficiary’s specific financial needs into account? For example, if the beneficiary is elderly and the trust is the beneficiary’s primary source of income, that would seem to dictate that the trustee–business manager avoid risks, such as expansion or development of new product lines that put a current strain on the business’s finances and are not likely to pay off in the beneficiary’s lifetime. Such an approach would certainly affect the long-term success of the business, however. This conflict is similar to the trustee’s conflict between serving an income beneficiary and a remainder beneficiary, and trust law has responded by imposing a duty of impartiality.\footnote{390}

The duty of impartiality requires that a trustee straddle the interests of the two, and not favor one over the other.\footnote{391} Applied to this scenario, the trustee–business manager would have to consider both the interests of the business and the interests of the beneficiary. Extension of the duty of impartiality to this scenario, where the trustee is allowed to include the interests of the business as an interest to be accommodated, would be a useful solution to the trustee–business manager’s dilemma. Application of this principle would depend on the circumstances, as does the duty of impartiality. For example, the beneficiary may not be very dependent on the trust income, and may be young and therefore interested in long-term business growth. That fact pattern would put the emphasis on the business’s interests over the beneficiary’s. Also, the extent of the beneficiary’s interest compared to other owners in the enterprise should also be considered. Other owners are in essence third-party beneficiaries of the health of the business enterprise. If the impartiality model is extended in this manner, it could also be adjusted by the terms of the trust agreement, as trustors can adjust the duty of impartiality among beneficiaries.\footnote{392} The impartiality approach is rather modest, however, and may not

\footnote{390. See Restatement (Second) of Trusts §§ 183, 232 (1959) (explaining that a trustee who has a duty to an income beneficiary and some other successive beneficiary must both work to create income from the property and avoid unproductive investments, while also avoiding investments that will cause the property to depreciate in value); Unif. Trust Code § 803, 7C U.L.A. 362 (2006) (noting the rule of impartiality).}

\footnote{391. See Restatement (Second) of Trusts § 232 cmt. b (describing the dual duties of a fiduciary who has to manage a trust to benefit both an income beneficiary and a remainder beneficiary).}

\footnote{392. For example, a trustor may specify in the trust instrument that the trustee is to consider the lifetime support of the income beneficiary as paramount, even if serving that interest jeopardizes the remaindermen’s interest.}
be sufficient to give the trustee–business manager enough flexibility to run the business successfully. Additional adjustment to the dual fiduciary’s duty is necessary.

The duty of care owed may be the easiest issue to tackle. The risk-taking necessary to run a business and the ability to be free from a requirement of diversifying risk both face constraints from the trustee’s duty of care. A trustor has significant power to reduce the trustee’s duty of care, as long as the trustee still acts with good faith. This power of the trustor, together with the implication that the trustor intended to reduce the duty of care by the creation of the dual role, should be enough to create a presumption that the dual-role fiduciary’s duty of care should be the lesser corporate duty. That presumption could be rebutted by statements of contrary intent by the trustor. This approach would directly recognize implied waivers of trustee duties by the trustor’s selection of fiduciaries. While some courts have gone this far, courts often require an express waiver of duties by the trustor.

This is a criticism raised by Professor Langbein in his argument that the contractarian view of trusts should be recognized. In addressing the imbedded conflicts with respect to the duty of loyalty, he gives as an example:

Low-grade conflicts of interest are especially endemic in family trusteeships. We see constantly in real-world practice some version of the case in which my father names me trustee for my mother for life, remainder to a group including me, with a power in the trustee to invade the corpus of the trust for the benefit of my mother in the event the life interest becomes inadequate for her comfort and support. My father has insisted on choosing a conflict-tainted trustee, making the judgment that I am to be trusted not to pauperize my mother to enrich myself. These situations are especially dangerous when the trust is given a controlling interest in a close corporation, and I am an officer of that firm. If

393. See supra notes 47–65 and accompanying text (describing a trustee’s duty to minimize risks).
394. Restatement (Third) of Trusts § 77 cmt. d (2007); 3 Scott, Fratcher & Ascher on Trusts, supra note 25, § 17.6, at 1209–10.
396. See Estate of Rothko, 379 N.Y.S.2d 923, 932–35 (Sur. Ct. 1975); Richard V. Wellman, Punitive Surcharges Against Disloyal Fiduciaries—Is Rothko Right?, 77 Mich. L. Rev. 95, 113–14 (1978) (arguing that by selecting trustees whom he knew would have conflicts of interest, Mark Rothko intentionally authorized those trustees to serve their own personal interests as well as the estate’s).
397. Langbein, supra note 24, at 667.
he is well counseled, my father spells out broad authority for me as trustee, expressly trumping the default standards of the duty of loyalty. But when he neglects that step, contractarian analysis encourages us to look at the real nature of the trust deal, that is, what he and I understood, or what we would have understood about the purposes of the trust and the standard for my trusteeship. The standard is not the same as when my father places a portfolio of fungible financial assets in trust with Wells Fargo or Northern Trust.\footnote{398. Id.}  

Using the presumption of implied waiver to go as low as the applicable business entity standard, complete with the business judgment rule, may not give sufficient consideration to the beneficiary’s inability to exit the arrangement or any particular vulnerabilities of the beneficiary. Recognition of the beneficiary’s situation may factor into the type of facts that could rebut the presumption of waiver, but some accommodation of the beneficiary’s interest may also require an upward adjustment of the duty of care, depending on the business entity form and the applicable duty. 

The duty of loyalty for the dual-role fiduciary is more troublesome. The Stegemeier case illustrated a direct conflict between the two roles where the fiduciary looks to transact business with the entity. The waiver of such a conflict implied by the trustor’s choice of fiduciary should lessen the burden, but dropping the fiduciary’s duty down to the business entity standard disregards the beneficiary’s status in a more sensitive context and without the countervailing considerations of the need for freedom to take risks in running the enterprise. The strict trustee duty, on the other hand, is too limiting in the context where the trustee is likely to have his or her own investment in the enterprise. Here, the duty of loyalty should be somewhere between the two. Professor Langbein proposed a new formulation of the trustee’s duty of loyalty, that of acting in the beneficiary’s best interest, rather than sole interest.\footnote{399. Langbein, \textit{supra} note 175, at 980–82.} Under Professor Langbein’s formulation, the fiduciary may serve his or her own interests, as long as those do not conflict with the beneficiaries.\footnote{400. Id.} His mechanism for doing so would be to convert the irrebuttable presumption of wrongdoing for self-dealing into a rebuttable one, allowing the trustee to defend an action of self-dealing on the

\begin{footnotesize}
\footnote{398. Id.}
\footnote{399. Langbein, \textit{supra} note 175, at 980–82.}
\footnote{400. Id.}
\end{footnotesize}
grounds that the beneficiaries’ interests were not harmed. His arguments for this dramatic adjustment in the centuries-old rule includes numerous examples where the trustee actions prohibited under the sole interest rule would in fact be beneficial to the beneficiaries. The dual fiduciary is a prominent example of potential harm to the beneficiaries because of the limitations on the trustee intended to protect the beneficiary. This approach has already appeared in the Uniform Trust Code, in circumstances where the transaction is between the trust and an affiliate of the trustee such as a spouse or controlled corporation. The best interest rule should be extended to circumstances where the fiduciary would be able to enter into the transaction under the rules of one role, that of business fiduciary, but not another, that of trustee.

In summary, a new hybrid set of rules should be developed to guide the dual fiduciary and to evaluate such a fiduciary’s actions. First, it should be explicitly recognized that the position of fiduciary to the business entity requires that the fiduciary balance the best interests of the entity with the best interests of the trust beneficiaries. In the Winston scenario, Ronald would be able to make decisions based on the well-being of the business as long as those decisions were not overly harmful to the interests of Bruce, the trust beneficiary. On the other hand, he would not be required to serve Bruce’s best interests if those were detrimental to the business. This balancing was recognized in the Rosencrans decision, which specifically recognized the interests of the corporation and the other shareholders as necessary factors in the dual fiduciary’s decisionmaking. The inclusion of the interests of the business entity and its other owners as part of the decisionmaking considerations does not adequately address the specific dilemmas of the dual fiduciary, however. In addition, it is necessary to acknowledge that the appointment of a dual fiduciary is in fact an implied waiver of strict duties of care and loyalty. With respect to duty of care, this implied waiver should allow for application of a modified business judgment rule, that requires consideration of the beneficiary’s more captive position than that of other business owners. For duty of loyalty, Professor Langbein’s proposal that the fiduciary can rebut allegations of breach of duty of loyalty with evidence that the beneficiaries’ interests were not harmed should be introduced in the context of

401. Id. at 980–81.
402. Id. at 954–57.
dual fiduciaries. This approach would allow the fiduciary to benefit personally as one of the business owners as well as to consider the business entity’s well-being and the interests of the other business owners. The formalization of this hybrid standard for dual fiduciaries would assist courts that heretofore have either drifted to one or the other set of standards depending on the culpability of the fiduciary or created ad hoc considerations to lessen the more strict duties of trustee while still trying to maintain special protections for beneficiaries.

V. CONCLUSION

The lot of a fiduciary is difficult enough because of the uncertainties of the extent of her duties and her exposure to liability to the beneficiaries. When the fiduciary serves in two different kinds of fiduciary roles with respect to the same property, knowing how to stay out of trouble becomes impossible. This is particularly true when the two roles are trustee and business entity fiduciary, at the two ends of the fiduciary duty spectrum. Courts have judged such fiduciaries with a variety of standards, based in part on the circumstances and sometimes on an assumption that using the stricter duty is the most reasonable choice. In the absence of clear direction from the trustor who put the fiduciary in such an ambiguous situation, courts should acknowledge the need for risktaking in business management and use the lower standard for duty of care. Courts should adjust the duty of loyalty and accommodate the imbedded conflicts with the fiduciary’s personal interests by using a standard of best interests of the beneficiary, rather than sole interest, as the limits of the duty of loyalty in this circumstance. The duty of impartiality owed by trustees should further be adjusted to allow consideration of the needs of the business in addition to the diverse needs of the beneficiaries. Although certainty is never possible for the fiduciary, codification of these standards for the dual-role fiduciary, similar to the codification of trustee duties now existing under the Uniform Trust Code, would give the dual-role fiduciary the most peace of mind when carrying out his duties.

405. See Langbein, supra note 175, at 980–81.
406. See supra Part III.B. (describing cases with multiple fiduciaries).