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Karen E. Boxx

University of Washington School of Law

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DISTINGUISHING TRUSTEES AND PROTECTING BENEFICIARIES: A RESPONSE TO PROFESSOR LESLIE

*Karen E. Boxx**

It has long been recognized that different types of fiduciaries must be held to different degrees of duty to their beneficiaries. As stated by Professor Scott:

Some fiduciary relationships are undoubtedly more intense than others. 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.¹

Although the extent of discretionary power held by the fiduciary is the primary reason for the sliding scale of fiduciary duty, other aspects of the fiduciary role at issue have played a role in defining the duty. For example, the larger the personal stake that the fiduciary has in the enterprise (such as a partner or majority shareholder), the lesser the duty of loyalty, because it is presumed the fiduciary's personal interests will contribute to the protection of the beneficiary.² In cases where a court has found a fiduciary relationship outside of the traditional categories, the duty imposed is usually defined by the facts of the relationship and the particular need for protection.³

The recognized variation in the stringencies of the duties is reflected in the lack of a uniform definition of fiduciary. Although scholars have struggled to devise a universal concept that would encompass all fiduciary relationships, they have yet to reach a consensus.⁴

* This is a revised version of a comment presented at the Trust Law In the 21st Century Conference held at Benjamin N. Cardozo School of Law, on September 19, 2005. The author is an associate professor at the University of Washington School of Law. The author is very grateful to Professor Melanie Leslie and Professor Stewart Sterk for giving her the opportunity to participate.

¹ Austin W. Scott, *The Fiduciary Principle*, 37 CAL. L. REV. 539, 541 (1949).

² See Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 J.L. & ECON. 425, 432-34 (1993).

³ E.g., *Taeger v. Catholic Family & Cmty. Servs.*, 995 P.2d 721 (Ariz. Ct. App. 1999) (fiduciary duty owed by adoption agency to adoptive parents limited to duty of disclosure); *Schneider v. Plymouth State Coll.*, 744 A.2d 101, 106 (N.H. 1999) (finding that school breached fiduciary duty to students to "create an environment in which the plaintiff could pursue her education free from sexual harassment"); see also Gregory B. Westfall, "But I Know It When I See It": *A Practical Framework for Analysis and Argument of Informal Fiduciary Relationships*, 23 TEX. TECH L. REV. 835 (1992).

⁴ 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."); J.C. Shepherd, *Towards a Unified Concept*

It is therefore understandable that courts and legislatures cling to what little certainty they can find. The role of trustee is the archetypal fiduciary relationship, with a long history of defined rules.⁵ Courts and legislatures are therefore reluctant to allow the ambiguity surrounding other fiduciary relationships to invade the one area thought to be settled. However, as Professor Leslie has astutely pointed out in her article, the roles of the professional institutional trustee and amateur family member trustee vary just as significantly as the roles of fiduciaries of different entities, such as trustee and corporate director.⁶

Parallels can be drawn to other types of fiduciaries. For example, the corporate manager/shareholder relationship in closely held corporations is functionally different than the manager/shareholder relationship in a publicly traded corporation, and that difference has been acknowledged as requiring different levels of fiduciary duty.⁷ Also, California statutes specifically acknowledge that an uncompensated attorney-in-fact or custodian under the Uniform Transfers to Minors Act should be held to a lower standard of care than one who is paid for his or her services.⁸

Courts should not be reluctant to move away from the rigid rules governing trustees, since they have in fact been trying to accomplish the same goal by more indirect means. Professor Leslie points to several reported decisions where courts have not enforced the no further inquiry rule where the trustee is an amateur.⁹ Careful review of those decisions show that in each case, however, the courts stuck to the technical requirements of the rule, either finding that the settlor had impliedly authorized the self-dealing or using another route to escape application of the rule.¹⁰

of Fiduciary Relationships, 97 LAW Q. REV. 51, 52 (1981); Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L.J. 879, 923 (1998) (calling fiduciary duty "among the law's most exotic species").

⁵ See John Langbein, *The Contractarian Basis of the Law of Trusts*, 105 YALE L.J. 625, 637 (1995).

⁶ Melanie B. Leslie, *Common Law, Common Sense: Fiduciary Standards and Trustee Identity*, 27 CARDOZO L. REV. 2713 (2006).

⁷ See Brent Nicholson, *The Fiduciary Duty of Close Corporation Shareholders: A Call for Legislation*, 30 AM. BUS. L.J. 513 (1992).

⁸ CAL. PROB. CODE §§ 4231, 3912(b)(1) (West 2006). The original Model Durable Power of Attorney Act also treated uncompensated attorneys in fact differently. NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS, HANDBOOK OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS AND PROCEEDINGS OF THE ANNUAL CONFERENCE MEETING IN ITS SEVENTY THIRD YEAR 279 (1964). The Model Act provided three alternative standards of liability for attorneys in fact, and one alternative provided that only compensated attorneys in fact would be held to the standard of care of other fiduciaries. The Commissioners who supported this alternative believed that a family member serving as attorney in fact without pay should be subject to only limited liability. *Id.*

⁹ See Leslie, *supra* note 6, at 2729 n.56.

¹⁰ Helman v. Mendelson, 769 A.2d 1025, 1040-41 (Md. Ct. Spec. App. 2001) (holding that

Acknowledging the need to treat the two types of trustees differently does not answer how each set of duties should be defined. Professor Leslie's proposal for the differing sets of duties is a good starting point but could benefit from further consideration and debate. For example, her argument that differences in ease of monitoring justify a stricter standard imposed on professional fiduciaries overlooks the unique difficulties of monitoring amateur fiduciaries.¹¹ Regular communication among family members is certainly not a given and not all amateur trustees hold a family relationship with the trust beneficiaries. Long held personal resentments and disagreements between fiduciary and beneficiary, not present with a professional trustee but possible with family member fiduciaries, can give rise to deliberate silence or even miscommunication. Even the well-meaning amateur may not have the skills or the time to give thorough, complete information to the beneficiaries. The opposite is true of professional trustees, who provide too much information in often overly complex statements incomprehensible to an unsophisticated beneficiary. Thus, while significant differences exist, both types of trustees present unique monitoring difficulties that must be considered when fashioning levels of fiduciary duty.

A key principle that distinguishes the trustee role, which is always stated without distinguishing between types of trustees, is the no further inquiry rule. Under that rule, if a trustee violates the prohibition against self-dealing, the beneficiaries may void the transaction regardless of the fairness of the transaction to the trust and its beneficiaries.¹² The general no further inquiry rule has exceptions established under common law: where the settlor waives the prohibition against self-dealing, where the beneficiary consents to or ratifies a self-dealing transaction, and where the trustee has advance court approval for a self-

loans from trust to trustee were not improper because trust contained exoneration clause); *Massara v. Henry*, C.A. No. 19646, 2000 Ohio App. LEXIS 5425, at *1 (Ohio Ct. App. Nov. 22, 2000) (granting summary judgment in favor of fiduciary because no evidence of damage to support breach of fiduciary duty claim; court did not consider no further inquiry rule because not raised by appellant and pleadings did not raise specific claims of self dealing); *Tays v. Matler*, 173 F.3d 864 (10th Cir. 1999) (“[T]he district court did not err in finding that [a good faith] exception exists where the settlor intended a conflict of interest and gave the trustee broad authority to invest trust funds.”) (quoting *Tays v. Metler*, No. 97-2317, 1999 U.S. App. LEXIS 4769 at *8 (10th Cir. Mar. 19, 1999)); *Warehime v. Warehime*, 761 A.2d 1138, 1142 (2001) (holding that where brother, who was shareholder and trustee of siblings’ voting trusts, restructured voting rights of shares before expiration of trusts to retain control, his actions were judged by exoneration clause in trust agreement that held trustee liable only for actions in bad faith or grossly negligent).

¹¹ See Leslie, *supra* note 6, at 2725-26.

¹² GEORGE GLEASON BOGERT & GEORGE TAYLOR BOGERT, *THE LAW OF TRUSTS AND TRUSTEES* § 543, at 247-48 (2d ed. 1993).

dealing transaction.¹³ Professor Leslie argues that the no further inquiry rule should be maintained for professional trustees because the beneficiaries will have difficulty detecting self-dealing transactions between professional trustees and their corporate affiliates from the complex statements provided to them.¹⁴ She further argues that amateur trustees should be judged on a good faith rule, allowing such trustees to defend a self-dealing transaction if it was entered into in good faith, on the grounds that such trustee's self-dealing is easier to detect and that since most such trustees do not know about the no further inquiry rule, it has no deterrent effect on them.¹⁵ Her article further characterizes the current state of the law as a refusal by courts to enforce no further inquiry against amateur trustees, and a statutory movement, initiated by the Uniform Trust Code (UTC), to eliminate the no further inquiry rule as it applies to professional trustees.¹⁶ The first point, about what the standard should be for each type of trustee, warrants further consideration of other characteristics of the two categories of trustee and the role of the no further inquiry rule in each context. First, however, I will address her description of the current state of the law, because my own view of it differs.

As to the application of the no further inquiry rule to amateur trustees, the cases cited by Professor Leslie in fact allow good faith to excuse self-dealing, contrary to the no further inquiry rule, where the transaction was not in fact harmful.¹⁷ But in each case, the court grounded the deviation on a well-recognized exception to the rule.¹⁸ The sampling of available reported cases is small, however, and we cannot know what is happening at the trial court level in unappealed cases. There are also contrary examples.¹⁹ Therefore, although Professor Leslie correctly points to these cases as evidence that courts do not want to impose liability on well-meaning amateur trustees who break the rules without doing harm,²⁰ I am not confident that we are now at the point that all courts will be able or willing to find a way not to apply the no further inquiry rule in such cases.

¹³ 2A AUSTIN WAKEMAN SCOTT & WILLIAM FRANKLIN FRATCHER, THE LAW OF TRUSTS § 170 (4th ed. 1987).

¹⁴ See Leslie, *supra* note 6, at 2717.

¹⁵ *Id.* at 2745-46.

¹⁶ See generally *id.*

¹⁷ The *Warehime* case may be an exception, since the trustee froze out the beneficiaries' voting rights, even though the court excused the conduct on the basis that it was in the best interests of the corporation whose stock was held in the trust. *Warehime* 761 A.2d 1138.

¹⁸ *Id.*

¹⁹ E.g., *In re Estate of Stowell*, 595 A.2d 1022 (Me. 1991); see also Charles Bryan Baron, *Self-Dealing Trustees and the Exoneration Clause: Can Trustees Ever Profit from Transactions Involving Trust Property?*, 72 ST. JOHN'S L. REV. 43 (1998).

²⁰ See Leslie, *supra* note 6, at 2729 n.56.

Professor Leslie's concern about the Uniform Trust Code's effect on corporate trustee liability is based on premises that I would again recharacterize. Section 802 of the UTC rephrases the common law test of what constitutes self-dealing and both narrows and expands trustee liability. Under common law, the no further inquiry rule applies in all cases of self-dealing, except for settlor waiver or beneficiary or court approval. If the transaction is not self-dealing, then it is tested under the duty of care, that is, the prudent person standard.²¹ To determine what is self-dealing, if the transaction is not directly between the trustee and the trust, the test is whether the trustee's personal interests are substantially affected.²² If the conflict does not rise to the level of "substantial," the transaction is not considered self-dealing and is approved if it meets the duty of care.²³ Thus, the beneficiary must show that the other party to the transaction was substantially allied with the trustee's own interests in order to obtain the benefit of the no further inquiry rule.

The Uniform Trust Code changes the question. First, under the UTC, no further inquiry applies only to direct transactions with the trustee.²⁴ If the transaction is with a party related to the trustee, the UTC gives the beneficiary a presumption that the transaction is voidable but allows the trustee to rebut the presumption.²⁵ The text of the statute does not set forth what is needed to rebut this presumption; the plain language of the statute only implies that the trustee must establish that the transaction was not affected by the conflict between the trustee's personal and fiduciary interests. The comments to section 802 state that the trustee would have to prove that the transaction was in the best interests of the trust and its beneficiaries.²⁶

The question thus shifts from the common law question of how close is the trustee's connection to the transaction to whether the transaction was in the trust's and beneficiaries' best interests.²⁷

²¹ In *Estate of Rothko*, the court imposed heightened damages in a case of conflict of interest that did not rise to self-dealing, but that case was unique. 372 N.E.2d 291 (N.Y. 1977).

²² 2A SCOTT & FRATCHER, *supra* note 13, § 170.10 at 346.

²³ *Id.* § 170.24, at 432-33.

²⁴ UNIF. TRUST CODE § 802(b) (2000).

²⁵ *Id.* § 802(c).

²⁶ It is critical to note that a uniform law's comments are not voted on by the Uniform Laws Commissioners, and are usually written by the Reporter in final form after completion of the Act. The UTC Comments should therefore be considered only guides to interpretation. Professor Leslie makes reference to the UTC Comments and this distinction is important to keep in mind when considering her comments as well. See Leslie, *supra* note 6, at 2730-31, 2749-52.

²⁷ The Comments to U.T.C. § 802 state that the fairness of the transaction is one piece of evidence that the transaction was in the trust's best interests. That is going too far, because a fairness test pushes the transaction down to a duty of care test, where conflict of interest is irrelevant.

When a trustee deals with a related party, there has always been an ambiguity that the beneficiary has to overcome. The UTC has simply changed to a perhaps more relevant question in those cases: Was the trust's best interest nevertheless served? Under the common law test, if the relationship is deemed too remote, then the transaction is tested just for fairness. Under the UTC, all transactions with a related party, no matter how remote, are tested for the trust's best interests.²⁸

Professor Leslie, on the other hand, reads UTC section 802 as essentially eliminating the no further inquiry rule for professional trustees.²⁹ She reaches this conclusion on the basis that most self-dealing by professional trustees will be done with affiliates, due to the current structure of institutional trustees (an assertion that is hard to disagree with),³⁰ and that allowing the trustee to rebut the presumption reduces the test of self-dealing to a test of whether the transaction was fair, similar to the test available to corporate directors.³¹

However, as noted above, the statute does not reduce the standard to a mere duty of care, but instead shifts an already present question of applicability of the no further inquiry rule to the question of whether the transaction was in the trust's best interests. The trustee would have the burden of rebutting the presumption of an impermissible conflict. Given the risk-averse inclination of professional trustees, the position of having to rebut a presumption would likely be almost as unpleasant as the threat of an irrebutable presumption and should not be discounted as a deterrent to a professional trustee. Also, the UTC's rephrasing of the question when the transaction involves a related party rather than the trustee itself focuses the issue on a less arbitrary standard than the degree of relationship with the trustee, and can therefore give the beneficiary an advantage in many cases.

Regardless of the current state of the law, the critical question remains how these two very different fiduciaries should be treated. Professor Leslie begins this analysis by considering potential variations

²⁸ This is a more stringent test than fairness because a fairness standard can be met if the price was fair, and that can be a fluid notion. Best interests, however, would consider other factors, such as whether the beneficiaries wanted the property sold. *See Allard v. Pac. Nat'l Bank*, 663 P.2d 104 (Wash. 1983).

²⁹ *See Leslie, supra note 6*, at 2731.

³⁰ Indeed, a potentially larger concern is the expansion of the safe harbors available to trustees (but mostly useful to professionals), which move certain self-dealing transactions to a duty of care test. *See UNIF. TRUST CODE* § 802(f), (h); *see also DEL. CODE ANN. tit. 12, § 3312* (2005) (providing a broad exception from self-dealing prohibition for all transactions with "affiliates," defined as any corporation or other entity that controls, is controlled by or is under common control with the trustee, as long as the trustee gives notice (which can be given in a prospectus) of all fees paid in connection with such transactions). The argument is that such transactions are necessary for efficient operation of trust management.

³¹ *See, e.g., MODEL BUS. CORP. ACT* § 8.61(b)(3) (2004).

in the rules regarding self-dealing and delegation. Looking at the differences identified by Professor Leslie suggests other ways of accommodating those differences. For example, she correctly points out that the settlor's intentions in selecting a professional trustee are very different than the intentions in selecting a family member.³² Acknowledging those different intentions can be done in different adjustments to the fiduciary rules other than a shift in the no further inquiry rule. For example, another way to protect beneficiaries from indifferent professional trustees is to increase the ease with which beneficiaries can remove a professional trustee and replace it with another professional.³³ If a professional trustee is treated as fungible, unless it could be shown that the settlor has strong reason for selecting and retaining the particular professional trustee, then the professional trustee would be forced to be responsive to the beneficiaries, thus addressing many of the problems raised by Professor Leslie. The pressure to provide safe harbors for professional trustees' transactions with affiliates³⁴ and the traditional ambiguity surrounding application of the no further inquiry rule when the transaction is with a related party³⁵ indicate that a tightening of the no further inquiry rule may not be a realistic solution to those problems.

With respect to the amateur trustees, Professor Leslie correctly notes that when the settlor chooses a family member or friend as trustee, that selection is most likely based on factors involving that particular person's attributes and relationships with the beneficiaries of the trust.³⁶ Often, the trustee has a beneficial interest in the trust, such as in cases where an adult child is named as trustee of a trust for settlor's surviving spouse, who may be parent of the trustee, where the adult child and her siblings are the remainder beneficiaries. The effect of the no further inquiry rule could be significantly ameliorated if courts recognized that the settlor has impliedly waived any conflicts or self-dealing prohibitions by putting a person with an interest in the trust in the position of trustee. Broadening the exceptions to the self-dealing rule to allow a good faith test where the structure of the trust indicates that such

³² See Leslie, *supra* note 6, at 2719.

³³ For example, UTC § 706 allows a court to remove a trustee at the request of a beneficiary, if "there has been a substantial change of circumstances or removal is requested by all of the qualified beneficiaries, the court finds that removal of the trustee best serves the interests of all of the beneficiaries and is not inconsistent with a material purpose of the trust, and a suitable cotrustee or successor trustee is available." UNIF. TRUST CODE § 706; *see also* WASH. REV. CODE § 11.98.039 (2005) (providing that a trust beneficiary may request the court for a change of trustee for any "reasonable cause," with no other restrictions on court's authority to change trustee).

³⁴ See *supra* note 30.

³⁵ See *supra* notes 22-23 and accompanying text.

³⁶ See Leslie, *supra* note 6, at 2719.

transactions would be within the settor's intent would be more narrow than moving to a good faith test for all amateur trustees, but the latter may negate the rule in cases where the traditional justifications for the rule are still present. The rule was intended to protect the beneficiary because of the difficulty of monitoring—particularly where the beneficiary has limited capacity—and the ease with which a trustee can abuse its power over another person's assets.³⁷ Just because a trustee does not perform those duties for a living does not necessarily mean that the need for protection lessens.

These are just preliminary thoughts regarding the optimal methods to distinguish these beneficiaries and to improve trust administration. Professor Leslie has demonstrated that separating the two with respect to fiduciary duties is a worthwhile inquiry. However, the differences and purposes of the rules governing trustees that she proposes be adjusted need to be analyzed from all angles before conclusions can be drawn about how best to accommodate the differences.

³⁷ Henry Hansmann & Ugo Mattei, *The Functions of Trust Law: A Comparative Legal and Economic Analysis*, 73 N.Y.U. L. REV. 434, 450 (1998).