Title

Those who would dilute the trustee's duty of undivided loyalty.

Text

As a general rule, the trustee has a duty to act *solely* in the interests of the beneficiaries. See, for example, UTC § 802(a), as well as the discussion of the no-further-inquiry rule in the Appendix below. That having been said, UTC § 802(g) provides that "[i]n voting shares of stock or in exercising powers of control over similar interests in other forms of enterprise, the trustee shall act in the *best* interests of the beneficiaries." Why the downgrade, particularly when the corporation is wholly owned? What is the policy rationale for diluting at the intersection of trust and corporate law the loyalty principle via an exemption from the no-further-inquiry rule? Whether the trustee as corporate manager should be governed by the business judgment rule rather than the prudent investor rule is a separate issue involving levels of acceptable risk. For a general discussion of whether a trustee's conduct as a matter of public policy should be subject to a sole-interests-of-the-beneficiary default standard, or the less rigorous best-interests-of-the-beneficiary default standard, see *Loring and Rounds: A Trustee's Handbook* §6.1.3, pages 471-473 of the 2018 Edition, which pages are reproduced in the Appendix below.

Appendix

From *Loring and Rounds: A Trustee's Handbook* §6.1.3 [pages 471-473 of the 2018 Edition]

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The no-further-inquiry rule. Under classic principles of trust law, the fact that the trustee engaged in an unauthorized act of self-dealing was all that the beneficiary needed to prove in an action to void the transaction. As no further proof was required, this came to be known as the "no further inquiry rule."[172] Whether the trustee acts in good faith[173] or pays a fair consideration[174] or erects a Chinese wall between its commercial and fiduciary departments[175] is immaterial.[176] The rule was marbled through the English common law[177] and is consistent with traditional civil law (continental) fiduciary principles.[178] It is a rule that the Restatement (Third) of Trusts for "prophylactic reasons"[179] has given its unqualified endorsement

[172]*See* Girod v. Girod, 45 U.S. 503, 553 (1846). *See generally* 3 Scott & Ascher §17.2.

[173]*See In re* Gleeson's Will, 124 N.E.2d 624 (Ill. App. 1955) ("The good faith and honesty of the … [trustee]… can avail … [him]… nothing so far as justification of the course he chose to take in dealing with trust proper is concerned.").

[174]*See In re* Gleeson's Will, 124 N.E.2d 624 (Ill. App. Ct. 1955) ("… [T]he fact that the trust sustained no loss on account of his dealings therewith … can avail … [the trustee]… nothing so far as justification of the course he chose to take in dealing with trust proper is concerned.").

[175]Lewin ¶20-61 (England); 3 Scott & Ascher §17.2.14.6 (noting that Chinese walls have generally proven "not very effective").

[176]*See* Girod v. Girod, 45 U.S. 503, 553 (1846).

[177]*See generally* Lewin ¶20-60.

[178]Girod v. Girod, 45 U.S. 503, 552–562 (1846). *See generally* §8.12.1 of this handbook (civil law alternatives to the trust).

[179]Restatement (Third) of Trusts §78 cmt. b. "In such situations, for reasons peculiar to typical trust relationships, the policy of the trust law is to prefer (as a matter of default law) to remove altogether the

and ratification.[180] It recognizes, however, that there are some long-standing exceptions to the rule that, for reasons of practicality, efficiency, and beneficiary interest, should be allowed to stand, *e.g.*, when the terms of the trust[181] or rulings of the court authorize a transaction that involves conflicting fiduciary and personal interests.[182] One commentator has articulated the rule's general policy underpinnings: In its wish to guard the highly valuable fiduciary relationships against improper administration, equity deems it better to forbid disloyalty and strike down all disloyal acts, rather than to attempt to justify … [the trustee's]… representation of two interests.[183]

The UTC's mere rebuttable presumption that the duty of loyalty has been breached in a transaction between the trustee, *qua* trustee, and his personal agent, his spouse, a close relative, or an affiliated third party would "lessen the reach" of the no-further-inquiry rule.[184] As a general matter, "the UTC arguably has weakened the trustee's fundamental duty of loyalty by treating it as just another default rule the settlor may override in the terms of the trust."[185]

John H. Langbein, an influential trust academic who has had minimal real-world law/trust practice experience, has been advocating for some time that trustees generally be held to a best-interests-of-beneficiary default standard rather than the traditional and more rigorous sole-interests-of-beneficiary default standard, in other words, that there be a generalized defanging of the no-further-inquiry rule.[186] The ivory tower, however, is not the real world, as another trust academic has reminded us:

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occasions of temptation rather than to monitor fiduciary behavior and attempt to uncover and punish abuses when a trustee has actually succumbed to temptation." Restatement (Third) of Trusts §78 cmt. b. "The inherent subjectivity and impracticability of second guessing a trustee's application of business judgment or exercise of fiduciary discretion are aggravated by the opportunities and relative ease of concealing misconduct—or at least by the absence of timely information and the likely disappearance of relevant evidence—that results from the trustee's day-to-day, usually long-term, management of the trust property and control over the trust records." Restatement (Third) of Trusts §78 cmt. b. "Viewed from the beneficiaries' perspective, especially that of remainder beneficiaries, efforts to prevent or detect actual improprieties can be expected to be inefficient if not ineffective." Restatement (Third) of Trusts §78 cmt. b. "Such efforts are likely to be wastefully expensive and to suffer from time lag and inadequacies of information, from a lack of relevant experience and understanding, and perhaps from want of resources to monitor trustee behavior and ultimately to litigate and expose actual instances of fiduciary misconduct." Restatement (Third) of Trusts §78 cmt. b. *But see* John H. Langbein, *Questioning the Trust Law Duty of Loyalty: Sole Interest or Best Interest?*, 114 Yale L.J. 929 (2005) (suggesting that profound historical changes over the past two centuries have rendered the no further inquiry rule obsolete). For the counterargument, *see* Leslie, *In Defense of the No Further Inquiry Rule: A Response to Professor John Langbein*, 47 Wm. & Mary L. Rev. 541 (2005).

[180]Restatement (Third) of Trusts §78 cmt. b.

[181]*See generally* 3 Scott & Ascher §17.2.11.

[182]Restatement (Third) of Trusts §78 cmt. c. *See generally* §7.1.2 of this handbook (defenses to allegations that the trustee breached the duty of loyalty); 3 Scott & Ascher §§17.2, 17.2.12.

[183]Bogert §543; Leslie, *In Defense of the No Further Inquiry Rule: A Response to Professor John Langbein*, 47 Wm. & Mary L. Rev. 541 (2005). *But see* John H. Langbein, *Questioning the Trust Law Duty of Loyalty: Sole Interest or Best Interest?*, 114 Yale L.J. 929 (2005) (suggesting that profound historical changes over the past two centuries have rendered the no further inquiry rule obsolete).

[184]UTC §802(c).

[185]Alan Newman, *Trust Law in the Twenty-First Century: Challenges to Fiduciary Accountability*, 29 Quinnipiac Prob. L.J. 261, 279 (2016) (referring to UTC §802 cmt.).

[186]For the case against a defanging of the no-further-inquiry rule, see Melanie B. Leslie, *In Defense of the No Further Inquiry Rule: A Response to Professor Langbein*, 47 Wm. & Mary L. Rev. 541, 550–567 (2005).

> Under the influence of law and economics theory, prominent scholars and reformers are rapidly dismantling the traditional legal and moral constraints on trustees. Trusts are becoming mere "contracts," and trust law nothing more than "default rules." "Efficiency" is triumphing over morality. In the law and economics universe of foresighted settlors, loyal trustees, informed beneficiaries, and sophisticated family and commercial creditors, trusting trustees may make sense. In the real world, however, it does not. A trust system that exalts trustee autonomy over accountability can and increasingly does impose significant human costs on all affected by trusts.[187]

In the agent-fiduciary space, unlike the trustee-fiduciary space, those who would water down the fiduciary principle have been scoring some direct hits. See, for example, §114(d) of the Uniform Power of Attorney Act: "An agent that acts with care, competence, and diligence for the best interest of the principal is not liable solely because the agent also benefits from the act or has an individual or conflicting interest in relation to the property or affairs of the principal."

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[187]Frances H. Foster, *American Trust Law in a Chinese Mirror*, 94 Minn. L. Rev. 602, 651 (2010). *See also* Frederick R. Franke, Jr., *Resisting the Contractarian Insurgency: The Uniform Trust Code, Fiduciary Duty, and Good Faith in Contract*, 36 ACTEC L.J. 517 (2010).