ISSN 1936-5349 (print)
ISSN 1936-5357 (online)

HARVARD

JOHN M. OLIN CENTER FOR LAW, ECONOMICS, AND BUSINESS

FIDUCIARY PRINCIPLES IN TRUST LAW

Robert H. Sitkoff

Forthcoming in *Oxford Handbook of Fiduciary Law*
Evan Criddle, Paul Miller, and Robert H. Sitkoff eds. (2019)

Discussion Paper No. 961

06/2018

Harvard Law School
Cambridge, MA 02138

Draft of June 14, 2018
Oxford Handbook of Fiduciary Law
(E. Criddle, P. Miller & R. Sitkoff eds., forthcoming 2019)

Fiduciary Principles in Trust Law

*Robert H. Sitkoff**

I. Introduction

A trust is the quintessential fiduciary relationship. In loose talk, people often say trustee when they mean fiduciary. Trust fiduciary law has had a strong influence on the fiduciary principles applicable in bankruptcy, charity, corporation, investment advice, and pension law, among others.[1]

The fiduciary nature of a trust is definitional. "A trust ... is a fiduciary relationship with respect to property ... subjecting the [trustee] to duties to deal with it for the benefit of charity or for one or more persons."[2] Relative to other fiduciary relationships, the fiduciary duties of a trustee are strict. Trust law frames the duty of *loyalty* as a "sole interest" rule, and the trust law duty of care, called *prudence* in trust parlance, is not softened by a business judgment rule. Although much of trust fiduciary law is default in character, some is mandatory. No matter the terms of a trust, a trustee must always act in good faith and in the interests of the beneficiaries. A trustee who does not comply with her fiduciary duties may be removed from office, and the beneficiaries will be entitled to remedies that may include make-whole equitable damages and disgorgement of any profit to the trustee.

This chapter canvasses the fiduciary principles applicable to a trustee of a donative, irrevocable private trust.[3] The prototype use for such a trust is for ongoing fiduciary administration of property down the generations, what has aptly been dubbed a "management trust."[4] The chapter thus sets to the side revocable, charitable, business, constructive, and resulting trusts.[5] The focus is on American law as typified by the

---

* John L. Gray Professor of Law, Harvard University, rsitkoff@law.harvard.edu. Portions of this chapter are freely adapted without further citation or attribution from Robert H. Sitkoff & Jesse Dukeminier, Wills, Trusts, and Estates (10th ed. 2017).

The author thanks Samuel Bray, Daniel Kelly, John Morley, Max Schanzenbach, and participants in the Fiduciary Law: Charting the Field conference at Harvard for helpful comments and suggestions, and Joe Ruckert for excellent research assistance. In accordance with Harvard Law School policy on conflicts of interest, the author discloses certain outside activities, one or more of which may relate to the subject matter of this chapter, at https://helios.law.harvard.edu/Public/Faculty/ConflictOfInterestReport.aspx?id=10813.

1 See John A.E. Pottow, Fiduciary Principles in Bankruptcy and Insolvency **[this volume]**; Lloyd Hitoshi Mayer, Fiduciary Principles in Charities and Nonprofits **[this volume]**; Julian Velasco, Fiduciary Principles in Corporate Law **[this volume]**; Arthur Laby, Fiduciary Principles in Investment Advice **[this volume]**; Dana Muir, Fiduciary Principles in Pension Law **[this volume]**.

2 Restatement (Third) of Trusts § 2 (Am. Law Inst. 2003).

3 Similar principles apply to the personal representative of a decedent's estate. See, e.g., Uniform Probate Code §§ 3-703, 3-711, 3-712 (Unif. Law Comm'n 1990).

4 John H. Langbein, The Rise of the Management Trust, 143 Tr. & Est. 52 (2004).

5 See Robert H. Sitkoff & Jesse Dukeminier, Wills, Trusts, and Estates, 131-32, 398-400, 417-18, 591, 759 (10th ed. 2017); Mayer, supra note 1.

enormously influential Restatements of Trusts and widely adopted Uniform Trust Code.[6]

The hallmark of a common law trust is bifurcation.[7] A donor, called a *settlor* in trust jargon, conveys property to a *trustee*, giving the trustee *legal title* to the property. However, the trustee's legal title is subject to *equitable* or *beneficial* ownership rights in one or more *beneficiaries*. This separation of legal and beneficial ownership—functionally a separation of ownership and control—imposes fiduciary intermediation between the beneficiary and the trust property.[8] Trusteeship involves *distribution*, *investment*, *custody*, and *administration* functions.

By making a transfer in trust rather than outright, a settlor ensures that the property will be managed and distributed in accordance with his wishes as expressed in the terms of the trust. A trust also allows the settlor to postpone important decisions about the investment and distribution of the trust property. Instead of imposing inflexible instructions in advance, the settlor may empower the trustee to decide how the property should be invested and distributed in light of changing market conditions and the beneficiaries' circumstances. A trust is therefore a powerful tool for implementing a settlor's *freedom of disposition*.[9]

In the days of yore, when the typical trust was used to avoid the feudal incidents and primogeniture in a conveyance of land, trust law protected the beneficiaries by allowing the trustee only those powers granted expressly by the terms of the trust.[10] In modern practice, in which wealth accumulation takes the form of liquid financial assets, both drafting norms and prevailing default law give the trustee broad powers of administration. Trustee empowerment, however, puts the beneficiaries at the peril of mismanagement or misappropriation by the trustee—a problem of *agency costs*.[11]

Trust law's answer to this problem of agency costs is to subject a trustee to *fiduciary duties* in the trustee's exercise or nonexercise of the trustee's powers. Fiduciary principles are thus the primary beneficiary safeguard in modern trust practice. The Restatement characterizes this as "a basic principle of trust administration," namely, that "all powers held in the capacity of trustee must be exercised, or not exercised, in accordance with the trustee's fiduciary obligations. Thus, even a power expressly conferred by the trust instrument, or by statute, is subject to the fundamental duties of

[6] See Sitkoff & Dukeminier, supra note 5, at 387-91 (describing sources of American trust law). On fiduciary principles in other common law jurisdictions, see Matthew Conaglen, Fiduciary Principles in Contemporary Common Law Systems, **this volume**.

[7] See Robert H. Sitkoff, Trust Law as Fiduciary Governance Plus Asset Partitioning, in The Worlds of the Trust (Lionel Smith ed., 2013).

[8] See Robert H. Sitkoff, An Agency Costs Theory of Trust Law, 89 Cornell L. Rev. 621 (2004).

[9] See Robert H. Sitkoff, Trusts and Estates: Implementing Freedom of Disposition, 58 St. Louis U. L.J. 643 (2014).

[10] See John H. Langbein, The Contractarian Basis of the Law of Trusts, 105 Yale L.J. 625 (1995).

[11] See Sitkoff, supra note 8; see also Robert H. Sitkoff, An Economic Theory of Fiduciary Law, in Philosophical Foundations of Fiduciary Law (Andrew Gold & Paul Miller eds., 2014).

prudence, loyalty, and impartiality, to a duty to adhere to the terms of the trust, and to the other fiduciary duties of trusteeship."[12]

The plan for the remainder of this chapter is as follows. Part II examines the trigger for finding a trust fiduciary relationship and the scope of that relationship. Part III examines the duty of loyalty. Part IV examines the duty of prudence across the distribution, investment, custodial, and administrative functions of trusteeship. Part V examines other fiduciary duties in trust law, including the prominent duty of impartiality and the increasingly salient duty to give information to the beneficiaries. Part VI considers the extent to which fiduciary principles in trust law are mandatory or may be waived by the settlor or by a beneficiary. Part VII examines the remedies available for a breach of duty by a trustee. Part VIII concludes.

II. Trigger and Scope

A trust must be created, and a trustee must accept the trusteeship, before trust fiduciary principles become applicable. The settlor must have intent to create a trust,[13] provide for ascertainable beneficiaries who can enforce the trust, and designate specific property, the res, to be held in trust.[14] If these elements are satisfied, but the settlor fails to name a trustee or the named trustee is unable or refuses to serve, a court will appoint a trustee; a trust will not fail for want of a trustee.[15]

A person who has not yet accepted a trusteeship (by words or by conduct) may decline to serve as trustee.[16] However, after accepting a trusteeship, the trustee may resign only as allowed by the terms of the trust, consent of the beneficiaries, or court order.[17] Even then, a trustee's resignation normally does not become effective until "the acceptance of the trusteeship by a new trustee,"[18] as the trust property must be safeguarded in the interim. Moreover, resigning "does not relieve the trustee from liability for breaches of trust committed prior to the time the resignation becomes effective."[19]

For the most part, a trustee's fiduciary duties apply to the trustee's exercise or nonexercise of the trustee's powers within the trust relationship. However, trust law also

[12] Restatement (Third) of Trusts § 70 cmt. a (Am. Law Inst. 2007); see also Unif. Trust Code § 815(b) (Unif. Law Comm'n 2003).

[13] The form of the settlor's manifestation of intent will depend on whether the trust is inter vivos, created by declaration of trust or deed of trust, or testamentary, created by will. See Sitkoff & Dukeminier, supra note 5, 401-14.

[14] See, e.g., Unif. Trust Code § 402 (Unif. Law Comm'n 2000). If the trust is testamentary or is to hold land, a writing may be required to satisfy the Wills Act or the Statute of Frauds. See Restatement (Third) of Trusts §§ 17, 22 (Am. Law Inst. 2003).

[15] See id. § 31.

[16] See id. § 35.

[17] See id. § 36.

[18] Id. cmt. a.

[19] Id. cmt. d; see also Unif. Trust Code §§ 701, 705 (Unif. Law Comm'n 2000).

recognizes extrinsic fiduciary duties applicable to the trustee's personal dealings with a beneficiary. A trustee must deal "fairly" and communicate "all material facts" to a beneficiary even when acting in a "personal capacity."[20] The rationale is that the trust relationship "may involve a confidential relationship," one that warrants a fiduciary penumbra around the trust relationship.[21]

A trustee's fiduciary duties are enforceable by any beneficiary whose beneficial interest is adversely affected by the trustee's breach of duty.[22] For this purpose, anyone who could receive a distribution of the trust property is a beneficiary without regard for the likelihood of such a distribution.[23]

III. Duty of Loyalty

The trust fiduciary law *duty of loyalty* requires undivided loyalty from a trustee. A trustee must "administer the trust *solely* in the interest of the beneficiaries."[24] A trustee must not "be influenced by the interest of any third person or by motives other than the accomplishment of the purposes of the trust."[25]

The trust law *sole interest rule* of undivided loyalty is implemented by a categorical prohibition, enforced by a *no further inquiry rule*, on "transactions that involve self-dealing or that otherwise involve or create a conflict between the trustee's fiduciary duties and personal interests."[26] Under the no further inquiry rule, "it is immaterial that the trustee may be able to show that the action in question was taken in good faith, that the terms of the transaction were fair, and that no profit resulted to the trustee."[27] The only defenses that the trustee may raise are that: (i) the settlor expressly or impliedly authorized the conflict in the terms of the trust; (ii) the beneficiary consented after full disclosure; or (iii) the trustee obtained judicial approval in advance.[28]

The sole interest rule, which is "particularly strict even by comparison to the standards of other fiduciary relationships,"[29] is prophylactic on grounds of agency costs containment. "The idea is to prevent misbehavior by erecting an irrebuttable presumption of wrongdoing whenever the trustee engages in conflict tainted transactions."[30] The Restatement explains:

---

[20] Restatement (Third) of Trusts § 78(3) (Am. Law Inst. 2007).

[21] Id. § 78 cmt. g.

[22] See id. § 94 cmt. b.

[23] See id.; Scanlan v. Eisenberg, 669 F.3d 838 (7th Cir. 2012).

[24] Id. § 78(1) (emphasis added).

[25] Id. § 78 cmt. f.

[26] Id. § 78(2) and cmt. b.

[27] Id. § 78 cmt. b.

[28] See id. cmts. c(1)-(3).

[29] Id. cmt. a.

[30] John H. Langbein & Daniel R. Fischel, ERISA's Fundamental Contradiction: The Exclusive Benefit Rule, 55 U. Chi. L. Rev. 1105, 1114-15 (1998).

> The fiduciary duty of undivided loyalty in the trust context ... is particularly intense so that … its prohibitions are absolute for prophylactic reasons. The rationale begins with a recognition that it may be difficult for a trustee to resist temptation when personal interests conflict with fiduciary duty. 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 occasions of temptation rather than to monitor fiduciary behavior and attempt to uncover and punish abuses when a trustee has actually succumbed to temptation. This policy of strict prohibition also provides a reasonable circumstantial assurance (except as waived by the settlor or an affected beneficiary) that beneficiaries will not be deprived of a trustee's disinterested and objective judgment.[31]

On a practical level, the sole interest rule avoids difficult ex post counterfactual disputes about the relative influence of a trustee's mixed motives. Acting with a mixed motive is a disloyal conflict of interest, full stop, even without self-dealing. The beneficiary need only establish the fact of the mixed motive—a breach of the duty of undivided loyalty—to prove breach of a fiduciary duty. The theory is that "these deals are so frequently undesirable that the costs of extirpating the entire class of transaction (a rule) are less than the costs of case-by-case adjudication (the fairness standard)."[32]

True, a disloyal trustee may not be liable for make-whole equitable damages if the beneficiary cannot prove a loss with reasonable certainty. However, a breach of the duty of loyalty would still entitle the beneficiary to other relief such as trustee removal, an injunction against further such conduct, disgorgement of profits, or unwinding the transaction by way of equitable lien, constructive trust, or otherwise.[33]

The sole interest rule is not without controversy. Some argue that trust law should switch to a best interest rule that, as in corporate law, would allow a trustee to defend a conflicted action as being fair and in the best interest of the beneficiary.[34] Nevertheless, as a matter of settled positive law, canonical trust authority is clear. A trustee must act "solely" in the interest of the beneficiary.

To address the problem of overbreadth, rather than switching to a best interest rule for all cases as suggested by critics, the sole interest rule has been subjected to a handful of exceptions. In such a case, the no further inquiry rule yields to allow further inquiry into good faith and fairness. For example, statutes in most states allow a corporate trustee to deposit trust property with its own banking department and to

---

[31] Restatement (Third) of Trusts § 78 cmt. b (Am. Law Inst. 2007).

[32] Robert H. Sitkoff, Trust Law, Corporate Law, and Capital Market Efficiency, 28 J. Corp. L. 565, 573-74 (2003) (emphasis removed).

[33] See infra Part VII.

[34] Compare John H. Langbein, Questioning the Trust Law Duty of Loyalty: Sole Interest or Best Interest?, 114 Yale L.J. 929 (2005), with Melanie B. Leslie, In Defense of the No Further Inquiry Rule: A Response to Professor John Langbein, 47 Wm. & Mary L. Rev. 541 (2005). On loyalty in corporate law, see see Velasco, supra note 1.

invest the trust property in a mutual fund operated by the trustee or an affiliate, provided the trustee acts prudently and in good faith.[35] Another exception allows the trustee to take reasonable compensation even though, strictly speaking, compensating oneself with trust funds is self-dealing.[36]

The no further inquiry rule is also inapplicable to a conflict authorized expressly or impliedly by the settlor.[37] For example, if *O* funds a trust with shares in a closely held corporation and then names as trustee *X*, a person who sits on the company's board of directors, *X* will have a conflict of interest in voting the trust's shares in company. But this conflict is structural, created by the settlor rather than provoked by *X*. Accordingly, *X* is not disabled by the conflict, and she may vote the trust's shares, but she must do so in good faith and in the best interests of the beneficiaries.[38]

A similar analysis applies to a trust in which the settlor names as trustee an income beneficiary, whose interests will sometimes be in conflict with those of the remainder beneficiary, or vice versa. Such a trustee-beneficiary may act in spite of the conflict, but the trustee remains subject to the fiduciary duties of trusteeship in so acting, in particular the duty of impartiality, as discussed below.[39]

In an authorized conflict-of-interest situation, fiduciary accountability in the form of "especially careful scrutiny" is the substitute beneficiary safeguard for disempowerment by the no further inquiry rule.[40] The Restatement explains:

> A trustee may be authorized by the terms of the trust, expressly or by implication, to engage in transactions that would otherwise be prohibited by the rules of undivided loyalty ... [H]owever, ... no matter how broad the provisions of a trust may be in conferring power to engage in self-dealing or other transactions involving a conflict of fiduciary and personal interests, a trustee violates the duty of loyalty to the beneficiaries by acting in bad faith or unfairly.[41]

IV. Duty of Prudence

The trust fiduciary law duty of care, known as the *duty of prudence*, imposes on a trustee an objective and relational standard of care. A trustee "has a duty to administer the trust as a prudent person would, in light of the purposes, terms, and other

[35] See Restatement (Third) of Trusts § 78 cmts. c(6) and c(8) (Am. Law Inst. 2007); Unif. Trust Code § 802(f) and (h)(4) (Unif. Law Comm'n 2004).

[36] See Restatement (Third) of Trusts § 78 cmt. c(4) (Am. Law Inst. 2007); Unif. Trust Code § 802(h)(2) (Unif. Law Comm'n 2004).

[37] See Restatement (Third) of Trusts § 78 cmt. c(2) (Am. Law Inst. 2007).

[38] See id. cmt. d(1).

[39] See infra Part V.A.

[40] Restatement (Third) of Trusts § 37 cmt. f(1) (Am. Law Inst. 2003).

[41] Id. § 78 cmt. c(2).

circumstances of the trust," exercising "reasonable care, skill, and caution."[42] A trustee with special skills, or who procured appointment by claiming to have special skills, has a duty to use those skills.[43] The duty of prudence applies to all functions of trusteeship: *distribution*, *investment*, *custody*, and *administration*.

A. Distribution

The *distribution function* of trusteeship involves making disbursements of income or principal to the beneficiaries in accordance with the terms of the trust, which may be mandatory or discretionary. In a *mandatory trust*, the trustee must make specified distributions. If *O* transfers property to *X* in trust to distribute all the income quarterly to *A*, *X* has no discretion over when, to whom, or in what amounts to make a distribution. It would be a breach of the duty of prudence, and specifically the rule that a trustee is under "a duty to administer the trust ... in accordance with the terms of the trust,"[44] for *X* not to distribute all income quarterly to *A*.[45]

In a *discretionary trust*, the trustee has discretion over when, to whom, or in what amounts to make a distribution. If *O* transfers property to *X* in trust to distribute all the income among *A*, *A*'s spouse, and *A*'s descendants in such amounts as the trustee determines, *X* must distribute all income currently, but has some discretion over to whom and in what amounts.

Discretionary trusts preserve flexibility across time. In the example just given, *X* may decide who among *A*, *A*'s spouse, and *A*'s descendants will receive the trust income. However, as a fiduciary, *X* must exercise this discretion prudently and in good faith. An exercise of discretion "beyond the bounds of a reasonable judgment" would constitute an abuse of that discretion in violation of *X*'s duty of prudence.[46]

A recurring issue involves terms of a trust that purport to free the trustee from accountability in making discretionary distributions by use of adjectives such as *sole*, *absolute*, or *uncontrolled* in describing the trustee's discretion. Under settled principles, such terms are understood to grant the trustee "the broadest extended discretion," but not to "relieve the trustee of all accountability."[47] Accordingly, "words such as 'absolute'

---

[42] Id. § 77(1)-(2); see also Uniform Trust Code § 804 (Unif. Law Comm'n 2000) (similar).

[43] See Restatement (Third) of Trusts § 77(3) (Am. Law Inst. 2007); Uniform Trust Code § 806 (Unif. Law Comm'n 2000).

[44] Restatement (Third) of Trusts § 76 (Am. Law Inst. 2007).

[45] Under traditional law, a trustee was liable for a mistaken delivery of trust property to an ineligible person even if "[t]he trustee ... reasonably believe[d] that the person" was a proper recipient. Restatement (Second) of Trusts § 226 cmt. b (Am. Law Inst. 1959). More recent authority has softened this rule, giving the trustee a defense of "diligent, good-faith efforts." Restatement (Third) of Trusts § 76 cmt. f (Am. Law Inst. 2007).

[46] Id. § 87 cmt. c.

[47] In re Trusts for McDonald, 953 N.Y.S.2d 751, 753 (N.Y. App. Div. 2012). As Judge Learned Hand explained, "no language, however strong, will entirely remove any power held in trust from the reach of a

or 'unlimited' or 'sole and uncontrolled' are not interpreted literally. Even under the broadest grant of fiduciary discretion, a trustee must act honestly and in a state of mind contemplated by the settlor. Thus, the court will not permit the trustee to act in bad faith or for some purpose or motive other than to accomplish the purposes of the discretionary power."[48]

Another distribution issue that has become salient of late is *trust decanting*.[49] In a trust decanting, a trustee who under the terms of a trust (the *first trust*) has a discretionary power over distribution uses that power to distribute the trust property to a new trust (the *second trust*) with updated provisions. Both statute and case law recognize decanting as within a trustee's distribution power, but that an exercise of this power to decant is subject to the trustee's fiduciary duties.[50]

B. Investment

The *investment function* of trusteeship involves reviewing the trust assets and then implementing an investment program that fits the terms and purpose of the trust and the circumstances of the beneficiaries. Trust law first prescribed *legal lists* of permitted investments, typically government bonds and first mortgages on real property. The legal lists were replaced by the *prudent man rule*, which was nominally more flexible, but as applied came to favor government bonds and disfavor stocks. Today all states have replaced the prudent man rule with the *prudent investor rule*.[51]

1. Codifying Portfolio Theory[52]

The prudent investor rule is based on the core teaching of *modern portfolio theory* that an investor should differentiate between *market risk*, which is inherent to participating in the market, and *idiosyncratic risk*, which is particular to a given investment. Generally speaking, to obtain a greater expected return, an investor must assume greater market risk. Market risk is thus compensated in that more exposure to market risk yields more expected return. Idiosyncratic risk, by contrast, is different because it is generally uncompensated. Such risk can be reduced or even eliminated by

court of equity. … [W]ere that not true, the power would not be held in trust at all; the language would be no more than a precatory admonition." Stix v. Commissioner, 152 F.2d 562, 563 (2d Cir. 1945).

[48] Restatement (Third) of Trusts § 50 cmt. c (Am. Law Inst. 2003); see also id. § 87 cmt. d (Am. Law Inst. 2007) (similar); Unif. Trust Code § 814(a) (Unif. Law Comm'n 2004) (similar).

[49] See Robert H. Sitkoff, The Rise of Trust Decanting in the United States, 23 Trusts & Trustees 976 (2017).

[50] See, e.g., Uniform Trust Decanting Act § 4(a) (Unif. Law Comm'n 2015); Hodges v. Johnson, 177 A.3d 86 (N.H. 2017).

[51] Most states adopted the rule by enacting a version of the Uniform Prudent Investor Act (Unif. Law Comm'n 1994), which is based on the 1992 predecessor to Restatement (Third) of Trusts §§ 90-92 (Am. Law Inst. 2007).

[52] This section is freely adapted without further citation or attribution from Max M. Schanzenbach & Robert H. Sitkoff, The Prudent Investor Rule and Market Risk: An Empirical Analysis, 14 J. Emp. Legal Stud. 129 (2017).

diversifying. It follows, therefore, that the prudence of a given investment must be considered in light of its contribution to the overall portfolio's expected risk and return.

The prudent investor rule implements the distinction between market and idiosyncratic risk with two core principles. First, "[a] trustee's investment and management decisions respecting individual assets must be evaluated not in isolation but in the context of the trust portfolio as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the trust."[53] Second, a trustee must "diversify the investments of the trust unless the trustee reasonably determines that, because of special circumstances, the purposes of the trust are better served without diversifying."[54]

Under the prudent investor rule, no investment is "per se prudent or imprudent."[55] Instead, a trustee may "invest in any kind of property or type of investment,"[56] subject to these two core principles of risk management. Structurally, therefore, the prudent investor rule is a facts-and-circumstances standard. The rule calls for "subjective judgments that are essentially unavoidable in the process of asset management, addressing the appropriate degree of risk to be undertaken in pursuit of a higher or lower level of expected return from the trust portfolio."[57]

Upon assuming office, a trustee has a "reasonable time" to "make and implement" a compliant investment program.[58] Thereafter, the trustee is under an "ongoing duty to monitor investments and to make portfolio adjustments if and as appropriate,"[59] for example, by rebalancing the portfolio in light of actual investment performance and changes in circumstances. The prudent investor rule thus governs the trustee's "continuing responsibility for oversight of the suitability of investments already made as well as the trustee's decisions respecting new investments."[60]

2. Recurring Difficulties

Most of the litigation under the prudent investor rule concerns diversification,[61] often involving an allegation that a trustee failed within a reasonable time to diversify a

[53] Uniform Prudent Investor Act § 2(b) (Unif. Law Comm'n 1994); see also Restatement (Third) of Trusts § 90(a) (Am. Law Inst. 2007) (similar).

[54] Uniform Prudent Investor Act § 3 (Unif. Law Comm'n 1994); see also Restatement (Third) of Trusts § 90(b) (Am. Law Inst. 2007) (similar).

[55] Restatement (Third) of Trusts § 90 cmt. f (Am. Law Inst. 2007).

[56] Uniform Prudent Investor Act § 2(e) (Unif. Law Comm'n 1994).

[57] Restatement (Third) of Trusts § 90 cmt. e(1) (Am. Law Inst. 2007).

[58] Uniform Prudent Investor Act § 4 (Unif. Law Comm'n 1994). What constitutes a reasonable time is highly fact-intensive. See Restatement (Third) of Trusts § 92 cmt. b (Am. Law Inst. 2007).

[59] Restatement (Third) of Trusts § 90 cmt. e(1) (Am. Law Inst. 2007); see also Tibble v. Edison Int'l, 135 S. Ct. 1823, 1828 (2015).

[60] Uniform Prudent Investor Act § 2 cmt. (Unif. Law Comm'n 1994).

[61] See Sitkoff & Dukeminier, supra note 5, at 641-42 (canvassing excuses for not diversifying).

portfolio that was imprudently concentrated at the time the trustee took office.[62] In a fair number of cases, the trustee has defended retention of a concentration on the basis of language in the trust instrument authorizing or perhaps even mandating retention.[63] In such a case, it is important to distinguish between a trust provision that *authorizes* retention irrespective of diversification and one that *directs* the trustee to do so.

The prevailing view is that a permissive authorization to retain an undiversified portfolio, which is common boilerplate,[64] does not excuse the trustee from liability if not diversifying was imprudent. In the words of the Scott treatise, "the trustee ordinarily remains subject to the duty of prudence, notwithstanding the fact that the terms of the trust purport to waive the duty to diversify. Pursuant to this continuing duty of prudence, the trustee may continue to be subject to a duty to consider the need for diversification."[65] The Restatement agrees: "[T]he fact that an investment is permitted does not relieve the trustee of the fundamental duty to act with prudence. The fiduciary must still exercise care, skill, and caution in making decisions to acquire or retain the investment."[66]

A direction to retain certain property is different. If the terms of a trust direct the trustee to retain certain property, under the duty to administer a trust in accordance with its terms, the trustee must do so, "and the trustee may be subject to liability for disposing of them if they subsequently increase in value."[67] However, the duty to conform to the terms of the trust is qualified by a duty to "petition the court for appropriate modification of or deviation from the terms of the trust" if conforming will "cause substantial harm to the trust or its beneficiaries."[68] Accordingly, if the terms of the trust require retention of specific property, but retention would be imprudent, the trustee is under a "duty to apply to the court for permission to sell."[69]

The question of mandatory retention has provoked scholarly debate. Some argue that a settlor's freedom of disposition should include a power to prescribe a mandatory investment program.[70] Others argue that, as a fiduciary, a trustee may never act in a

---

[62] See, e.g., In re Estate of Janes, 681 N.E.2d 332 (N.Y. 1997).

[63] See, e.g., Wood v. U.S. Bank, N.A., 828 N.E.2d 1072 (Ohio App. 2005).

[64] See, e.g., Northern Trust, Will and Trust Forms 201-31 (2014) ("the trustee may retain or make any investment without liability").

[65] 4 Austin Wakeman Scott, William Franklin Fratcher & Mark L. Ascher, Scott and Ascher on Trusts § 19.2 (4th ed. 2017) [hereafter "Scott and Ascher on Trusts"].

[66] Restatement (Third) of Trusts § 91 cmt. f (Am. Law Inst. 2007).

[67] Scott and Ascher on Trusts, supra note 65, § 19.3.3.

[68] Restatement (Third) of Trusts § 66(2) (Am. Law Inst. 2003). Such a petition is a form of petition for instructions. See id. § 71.

[69] Scott and Ascher on Trusts, supra note 65, § 19.3.3. The most famous example is Matter of Pulitzer, 249 N.Y.S. 87 (N.Y. Sur. 1931), aff'd mem., 260 N.Y.S. 975 (N.Y. App. Div. 1932); see also In re Estate of Chamberlin, 23 N.Y.S.3d 658 (N.Y. App. Div. 2016) (recent example).

[70] See Jeffrey A. Cooper, Shades of Gray: Applying the Benefit-the-Beneficiaries Rule to Trust Investment Directives, 90 B.U. L. Rev. 2383 (2010); Jeffrey A. Cooper, Dead Hand Investing: The Enforceability of Trust Investment Directives, 37 ACTEC L.J. 365 (2011).

manner that is inimical to the beneficiary's welfare, and a settlor's freedom of disposition cannot include a power to negate the core principle that a trust is a fiduciary relationship for the benefit of the beneficiary.[71] In a handful of states, legislation purports to validate a mandatory direction not to diversify,[72] though these statutes have yet to be tested in a reported appellate decision.

One final recurring area of difficulty warrants mention. When a trustee is also an officer of a business entity in which the trust holds an ownership interest, the question may arise whether in a suit by a beneficiary the trustee's actions with respect to managing the entity should be judged by the fiduciary principles of the applicable entity law rather than trust fiduciary principles. The better view is that in a suit by a beneficiary for breach of trust, the trustee's conduct, even when acting as an officer of the underlying entity, is subject to review under trust fiduciary principles so that the "trustee may not use the corporate form to escape the fiduciary duties of trust law."[73]

C. Custody and Administration

A standard application of prudence in the *custodial function* is the duty to *collect* and *protect* the trust property without unreasonable delay.[74] What is unreasonable delay, and what steps are reasonably necessary, depend on the circumstances.[75] For example, precious jewelry or a priceless work of art should be secured against theft and insured against loss.

Another application of the duty of prudence in the custodial function is the duty to *earmark* trust property, that is, to designate it as trust property distinct from the trustee's own property.[76] For example, "deposits of trust money in a bank should be made in a separate account in the name of the trustee as trustee," and "title to land acquired by a trustee as such should be taken and recorded in the name of the trustee as trustee."[77] An egregious breach of the earmarking rules, raising both loyalty and prudence concerns, involves the *commingling* of trust property with the trustee's own property. A trustee must "keep trust property separate from the trustee's own property."[78] A trustee who commingles trust property with his own is in breach of trust even if the trustee does not use the trust funds for his own purposes.

Turning to *administration*, a trustee must maintain *adequate records* of the trust

[71] See John H. Langbein, Burn the Rembrandt? Trust Law's Limits on the Settlor's Power to Direct Investments, 90 B.U. L. Rev. 375 (2010).

[72] See, e.g., Del. Code tit. 12, §§ 3303(a)(3) (2017).

[73] Unif. Trust Code § 802 cmt (Unif. Law Comm'n 2004).

[74] See id. § 809.

[75] See Restatement (Third) of Trusts § 76 cmt. d (Am. Law Inst. 2007).

[76] See Unif. Trust Code § 810(c) (Unif. Law Comm'n 2000).

[77] Restatement (Third) of Trusts § 84 cmt. d (Am. Law Inst. 2007).

[78] Unif. Trust Code § 810(b) (Unif. Law Comm'n 2000).

property and the administration of the trust,[79] including documentation of important decisions and actions and the trustee's reasoning for those decisions and actions. Such recordkeeping (i) promotes prudent and loyal administration by imposing discipline on the trustee; (ii) enables the beneficiaries to undertake a meaningful review of the trustee's administration of the trust; and (iii) protects the trustee against hindsight bias by memorializing the trustee's analysis of the relevant circumstances as they existed at the time of the decision or action. A failure to maintain adequate records entitles a court "to resolve doubts against the trustee."[80]

A trustee is also under a duty to "take reasonable steps to *enforce claims* of the trust and to *defend claims* against the trust,"[81] including "to redress a breach of trust … by a former trustee."[82] The duty to bring and defend claims is informed by the trustee's duty of *cost sensitivity*, that is, to incur only reasonable costs.[83] Thus, a trustee should consider "the likelihood of recovery and the cost of suit and enforcement," litigating cost-effective claims and compromising or dropping claims that are not cost effective.[84]

V. Other Fiduciary Duties

Trust fiduciary law is replete with subsidiary fiduciary duties that implement the duties of loyalty and prudence as applied to recurring facts and circumstances.[85] We have already encountered several examples, including: (i) the prudent investor rule, and the duty to diversify and the duty to monitor that are subsumed within that rule; (ii) the duty to administer the trust in accordance with its terms but to petition the court if adhering to those terms would work harm upon the beneficiaries; (iii) the duty to collect and protect the trust property, to earmark it, and not to commingle it; (iv) the duty to keep adequate records of the administration of the trust; (v) the duty to bring and defend claims of the trust; and (vi) the duty to be cost sensitive in the sense of incurring only reasonable costs. Beyond these examples, perhaps the most important other fiduciary duties in trust law are (a) the duty of impartiality, and (b) the duty to give information and account to the beneficiaries. We will also consider (c) monitoring in divided trusteeship by way of co-trustees or delegation.

A. Duty of Impartiality

A trustee must act solely in the interests of the beneficiaries.[86] But how is a trustee to aggregate the potentially conflicting interests of multiple beneficiaries? Under the duty of *impartiality*, a "trustee must act impartially and with due regard for the

79 See id. § 810(a).

80 Restatement (Third) of Trusts § 83 cmt. a(1) (Am. Law Inst. 2007).

81 Unif. Trust Code § 811 (Unif. Law Comm'n 2000) (emphasis added).

82 Id. § 812.

83 See id. § 805; Restatement (Third) of Trusts § 88 (Am. Law Inst. 2007).

84 Unif. Trust Code § 811 cmt (Unif. Law Comm'n 2000)

85 See Robert H. Sitkoff, Other Fiduciary Duties: Implementing Loyalty and Care **[this volume]**.

86 See supra Part III.

diverse beneficial interests created by the terms of the trust."[87]

The duty of impartiality is unfortunately named. It does not require impartiality in the sense of equality. Instead, it requires a trustee to give *due regard* to the beneficiaries' respective interests as defined by the settlor in the terms of the trust. In some circumstances, the terms of the trust may permit or even require the trustee to favor the interests of one beneficiary over another. For example, in a trust for a surviving spouse for life, remainder to the settlor's descendants, the settlor may intend for the trustee to favor the spouse's comfortable support over the descendants' remainder interests.[88]

Impartiality problems are most common, as in the example just given, among current and successive beneficiaries. To sharpen that example, suppose *T* devises a fund in trust to *X* "to pay the income to *A* for life and then the principal to *B* on *A*'s death." The problem is that under traditional trust fiduciary accounting rules, the particular *form* of an investment return determines its classification as *income* or *principal*. The income beneficiary, *A*, will prefer investments that produce returns that are classified as income while *B*, the principal beneficiary, will prefer investments that produce returns that are classified as principal. Under traditional law, rents, cash dividends on common stock, and interest on bonds are classified as income, but increases in asset value, such as stock or land appreciation, are classified as principal.[89]

The embrace of modern portfolio theory by the prudent investor rule brought into sharp relief the skewing effect in the investment function of allocating income and principal in the distribution function based solely on the form of the trust's investment returns. As the Restatement explains, "only when beneficial rights do not turn on a distinction between income and principal is the trustee allowed to focus on total return ... without regard to the income component of that return."[90]

To free the trustee's hand in crafting a portfolio for total return without regard for the formal characterization of that return as principal or income, two reforms have taken root. The first is to give the trustee a *power to adjust* between income and principal.[91] Under this reform, the traditional allocation to income or principal on the basis of form abides, but the trustee is given a power to adjust—to reallocate—between principal and income as necessary to comply with the duty of impartiality. The second reform is a *unitrust*, in which a percentage (usually three to five percent) of the value of the trust corpus is paid to the income beneficiary each year. Both reforms free the trustee to focus on risk and return without regard for the form in which that return comes, separating prudence in the investment function from impartiality in the

[87] Restatement (Third) of Trusts § 79 (Am. Law Inst. 2007); see also Uniform Trust Code § 803 (Unif. Law Comm'n 2000) (similar).

[88] See, e.g., Howard v. Howard, 156 P.3d 89 (Or. App. 2007).

[89] See Unif. Principal and Income Act (Unif. Law Comm'n 1931, rev. 1962).

[90] Restatement (Third) of Trusts § 90 cmt. i (Am. Law Inst. 2007).

[91] See Unif. Principal and Income Act § 104 (Unif. Law Comm'n 1997).

distribution function.

B. The Duty to Inform and Account

A trustee is under an ongoing duty to keep the beneficiaries informed about the administration of the trust.[92] This duty manifests most commonly in one of three forms. First, a trustee is under a duty to respond promptly "to a beneficiary's request for information related to the administration of the trust."[93] Under traditional law, a settlor cannot override this right of a beneficiary as to information reasonably necessary for the beneficiary to protect her interest in the trust.[94]

With the codification of this mandatory rule by the Uniform Trust Code, several states enacted modified versions that purport to allow a "silent" or "quiet" trust in which the settlor could negate a beneficiary's right to information.[95] In 2004, the relevant provisions of the Uniform Trust Code were put in brackets, signaling that uniformity across the states is not expected.[96] Nevertheless, because fiduciary accountability is central to trusteeship, the cases continue to hold that a beneficiary is always entitled to information "reasonably necessary to enforce" the beneficiary's "rights under the trust ... notwithstanding the terms of the trust instrument. Any other conclusion renders the trust unenforceable by those it was meant to benefit."[97]

Second, the common law has come to recognize a duty in a trustee to make affirmative disclosure to the beneficiaries of significant or nonroutine developments in the administration of the trust.[98] Examples include changes "in investment or other management strategies" or "significant actions ... involving hard-to-value assets or special sensitivity to beneficiaries."[99] Affirmative disclosure of such matters puts the beneficiaries on notice, giving them an opportunity to object or otherwise protect their interests, for example by seeking a court order enjoining the trustee from the proposed course of action.

Third, a trustee is not liable to a beneficiary for a breach of trust if the facts of the breach are fairly disclosed in a formal accounting filed with the court, notice of the accounting is properly served on the beneficiary, and the beneficiary does not timely object. A beneficiary who does not object is barred by res judicata from later bringing a

---

[92] See Restatement (Third) of Trusts § 82 (Am. Law Inst. 2007); Unif. Trust Code § 813 (Unif. Law Comm'n 2004).

[93] Unif. Trust Code § 813(a) (Unif. Law Comm'n 2004).

[94] See Restatement (Second) of Trusts § 173 cmt. c (Am. Law Inst. 1959).

[95] See Jay A. Soled et al., Quiet Trusts: When Mum's the Word to Trust Beneficiaries, 40 Est. Plan. 13 (July 2013); Thomas P. Gallanis, The Trustee's Duty to Inform, 85 N.C. L. Rev. 1595 (2007).

[96] See Unif. Trust Code § 105(b)(8)-(9) and cmt. (Unif. Law Comm'n 2018).

[97] Wilson v. Wilson, 690 S.E.2d 710, 716 (N.C. Ct. App. 2010); see also Restatement (Third) of Trusts § 82 cmt. e (Am. Law Inst. 2007).

[98] See Restatement (Third) of Trusts § 82 cmt. d (Am. Law Inst. 2007); Unif. Trust Code. § 813 cmt. (Unif. Law comm'n 2004). The leading case is Allard v. Pacific National Bank, 663 P.2d 104 (Wash. 1983).

[99] Restatement (Third) of Trusts § 82 cmt. d (Am. Law Inst. 2007).

claim against the trustee that could have been brought in the accounting proceeding.

Because a formal judicial accounting is expensive, a movement has arisen toward informal, nonjudicial accountings. Under traditional law, the enforceability of an informal accounting provision was uncertain.[100] Modern law is more receptive to trust provisions that authorize an informal accounting, and many states permit an informal accounting by default even without an authorizing provision in the terms of the trust. The Uniform Trust Code welcomes informal accountings, called a "report" by the Code, and provides for a one-year limitations period to provide repose as to all matters fairly disclosed in the report.[101]

C. Monitoring in Divided Trusteeship

Two additional trust fiduciary principles merit attention. First, a trustee may delegate a function of trusteeship if the trustee exercises prudence in selecting, instructing, and periodically monitoring the agent. A trustee who does so is not liable for the misconduct of the agent. Instead, the agent owes a duty of reasonable care to the trust. In effect, the agent is substituted for the trustee with respect to the delegated function.[102] Second, in a co-trusteeship, "even in matters for which a trustee is relieved of responsibility, ... if the trustee knows that a co-trustee is committing or attempting to commit a breach of trust, the trustee has a duty to take reasonable steps to prevent the fiduciary misconduct."[103] The theme that ties these two principles together is that each involves a trustee's ongoing duty of monitoring even if nominally relieved of responsibility.

VI. Mandatory and Default Rules

As we have seen, the fiduciary nature of trusteeship is definitional. "A trust ... is a fiduciary relationship with respect to property ... subjecting the [trustee] to duties to deal with it for the benefit of charity or for one or more persons."[104] In consequence, "all powers held in the capacity of trustee must be exercised, or not exercised, in accordance with the trustee's fiduciary obligations."[105] But what if (a) the settlor purports to waive a fiduciary duty in the terms of the trust, or (b) a beneficiary purports to grant a consent or release for conduct that would otherwise constitute a breach of duty?

A. The Terms of the Trust

---

[100] See, e.g., Marsman v. Nasca, 573 N.E.2d 1025, 798 n.8 (Mass. App. Ct. 1991) (quoting treatise that informal accounting "is an unsafe procedure for the trustee").

[101] See Unif. Trust Code §§ 813(c) and 1005(a) (Unif. Law Comm'n 2004).

[102] See Restatement (Third) of Trusts § 80 (Am. Law Inst. 2007); Unif. Trust Code § 807 (Unif. Law Comm'n 2000).

[103] Restatement (Third) of Trusts § 81 cmt. b (Am. Law Inst. 2007).

[104] Id. § 2.

[105] Id. § 70 cmt. a.

The terms of a trust cannot vary a trustee's duty to act "in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries."[106] Elsewhere I have suggested in explanation that "fiduciary obligation is a necessary constitutive element of certain legal categories, such as trust and agency. … A person may give property to another person and authorize the other person to act whimsically with respect to the property. But this mode of transfer is an absolute gift, and this mode of holding property is fee simple."[107] Because the terms of a trust cannot override the fiduciary nature of trusteeship, those terms cannot negate a trustee's duty to act in good faith in the interests of the beneficiary.

In *McNeil v. McNeil*, decided by the Delaware Supreme Court in 2002, at issue was a clause stating that the trustees' decisions were "not subject to review by any court."[108] Observing that courts "flatly refuse to enforce provisions relieving a trustee of all liability," the court reviewed the trustees' actions nonetheless.[109] "A trust in which there is no legally binding obligation on a trustee is a trust in name only and more in the nature of an absolute estate or fee simple grant of property."[110] A few years earlier, in *Armitage v. Nurse*, Lord Justice Millet applied the same principle to an English trust, explaining that "there is an irreducible core of obligations owed by the trustees to the beneficiaries and enforceable by them which is fundamental to the concept of a trust. If the beneficiaries have no rights enforceable against the trustees there are no trusts."[111]

We have already seen several applications of a trustee's unwaivable duty to act in good faith in the interests of the beneficiary, including the rules that: (i) even in an authorized conflict-of-interest situation, "a trustee violates the duty of loyalty to the beneficiaries by acting in bad faith or unfairly";[112] (ii) a grant of "sole," "absolute," or "uncontrolled" discretion is "not interpreted literally," so that a "court will not permit the trustee to act in bad faith or for some purpose or motive other than to accomplish the purposes of the discretionary power";[113] (iii) although a trustee is under a duty to administer a trust in accordance with its terms, the trustee must petition the court if in light of the circumstances doing so will "cause substantial harm to the trust or its beneficiaries";[114] and (iv) a beneficiary is always entitled to information "reasonably

[106] Unif. Trust Code § 105(b)(2) (Unif. Law Comm'n 2018); see also Restatement (Third) of Trusts §§ 78 cmt. c(2) and 96(1)(a) (Am. Law. Inst. 2007, 2012); John H. Langbein, Mandatory Rules in the Law of Trusts, 98 Nw. U. L. Rev. 1105 (2004).

[107] Sitkoff, supra note 11, at 205. This theory is an application of the *numerus clausus* principle. See, e.g., Thomas W. Merrill & Henry E. Smith, Optimal Standardization in the Law of Property: The Numerus Clausus Principle, 110 Yale L.J. 1 (2000).

[108] 798 A.2d 503, 508 (Del. 2002).

[109] Id. at 509.

[110] Id.

[111] [1998] Ch. 241 at 253 (Eng.); see also David Hayton, The Irreducible Core Content of Trusteeship, *in* Trends in Contemporary Trust Law (A.J. Oakley ed., 2004).

[112] See supra note 41 and text accompanying.

[113] See supra notes 47-48 and text accompanying.

[114] See supra note 68 and text accompanying.

necessary to enforce" the beneficiary's "rights under the trust … notwithstanding the terms of the trust instrument."[115]

Perhaps the most salient further example is the effect of an *exoneration* or *exculpation* clause. Such a clause protects the trustee against personal liability for surcharge, reducing the trustee's personal liability exposure. However, the trustee may still be removed from office and the beneficiaries may still be entitled to other relief. Moreover, in accordance with the mandatory core of trust fiduciary law, even if a fully informed settlor knowingly includes an exculpation clause in the terms of a trust, the clause cannot exculpate *bad faith*, *reckless indifference*, or *intentional or willful neglect* by the trustee. The Restatement explains:

> Notwithstanding the breadth of language in a trust provision relieving a trustee from liability for breach of trust, for reasons of policy trust fiduciary law imposes limitations on the types and degree of misconduct for which the trustee can be excused from liability. Hence, an exculpatory clause cannot excuse a trustee for a breach of trust committed in bad faith. Nor can the trustee be excused for a breach committed with indifference to the interests of the beneficiaries or to the terms and purposes of the trust—that is, committed without reasonable effort to understand and conform to applicable fiduciary duties.[116]

A conceptually related question is whether the settlor may mandate *arbitration* of trust disputes. The authorities are scarce and contradictory,[117] and commentators are by no means in agreement on the policy analysis.[118] Some courts have reasoned that, because a beneficiary is not a party to the arbitration agreement (i.e., the trust instrument), the beneficiary cannot be compelled to arbitrate.[119] Other courts have reasoned that, because a trust is a conditional gift in which the beneficiary takes her interest subject to the conditions imposed by the settlor, the relevant question is whether the settlor consented.[120] The hard policy question is whether accountability in court, before a judge, is part of the mandatory fiduciary core that cannot be waived by the settlor.

---

[115] See supra note 94-97 and text accompanying.

[116] Restatement (Third) of Trusts § 96 cmt. c (Am. Law Inst. 2012); see also Uniform Trust Code §§ 105(b)(10) and 1008(a) (2000) (similar).

[117] See Mary F. Radford, Trust Arbitration in United States Courts, in Arbitration of Trust Disputes 175 (S.I. Strong ed., 2016).

[118] See, e.g., Jessica Beess und Chrostin, Mandatory Arbitration Clauses in Donative Instruments: A Taxonomy of Disputes and Type-Differentiated Analysis, 49 Real Prop. Tr. & Est. L.J. 397 (2014); Erin Katzen, Arbitration Clauses in Wills and Trusts: Defining the Parameters for Mandatory Arbitration of Wills and Trusts, 24 Quinnipiac Prob. L.J. 118 (2011).

[119] See Schoneberger v. Oelze, 96 P.3d 1078 (Ariz. Ct. App. 2004).

[120] See Rachal v. Reitz, 403 S.W.3d 840 (Tex. 2013).

The question of a mandatory core in trust fiduciary law also arises in a *directed trust*.[121] In a directed trust, a person known as a "trust director," "trust protector," or "trust adviser" can have extensive power over the trust without being a trustee or holding title to the trust property. The responsibilities of a trustee in a directed trust are often so limited that the trustee may be known as a "directed trustee" or "administrative trustee." There is a consensus across the states that a trust director is at least a presumptive fiduciary. There is less consensus about the fiduciary duties, if any, of a directed trustee.

Among the states that have legislated specifically on the duties of a directed trustee, one group provides that a directed trustee has no duty other than to comply with a direction from a trust director,[122] though as yet there is no case law confirming that courts will follow this interpretation. Another group provides that a directed trustee is not liable for complying with a direction of a trust director unless by doing so the directed trustee would personally engage in "willful" or "intentional" misconduct.[123] The Uniform Directed Trust Act, promulgated in 2017, prescribes a "willful misconduct" rule for a directed trustee,[124] and applies the same default and mandatory fiduciary principles to a trust director as would apply to a trustee in "a like position and under similar circumstances."[125]

B. Beneficiary Authorization

Authorization by a beneficiary to a trustee's breach of fiduciary duty, formally a *consent* if given in advance and a *release* if given after the fact,[126] is conceptually simpler than a waiver by a settlor in the terms of a trust, as beneficiary authorization involves a waiver of a right held by that beneficiary. A beneficiary who has given a proper consent or release for "an act or omission that constitutes a breach of trust cannot hold the trustee liable for that breach."[127]

However, because of the fiduciary rather than arm's length nature of the relationship, and because a trustee's act of obtaining beneficiary authorization is necessarily a conflicted action, trust law imposes substantive and procedural safeguards. A consent or release is enforceable only if the beneficiary "was aware of the beneficiary's rights and of all material facts and implications that the trustee knew or should have

121 See John D. Morley & Robert H. Sitkoff, Making Directed Trusts Work: The Uniform Directed Trust Act, 44 ACTEC L.J. 1 (forthcoming 2018), on which this and the next paragraph draw.

122 See Alaska Stat. § 13.36.375(c); N.H. Rev. Stat. Ann. § 564-B:8-808; Nev. Rev. Stat. § 163.5549(1); S.D. Codified Laws § 55-1B-2.

123 See Del. Code Ann. tit. 12, § 3313; 760 Ill. Comp. Stat. 5/16.3(f); Tex. Prop. Code Ann. § 114.003; Va. Code Ann. § 64.2-770.

124 Unif. Directed Trust Act § 9(b) (Unif. Law Comm'n 2017).

125 Id. § 8(a)(1)(B).

126 See Restatement (Third) of Trusts § 97 cmt. b (Am. Law Inst. 2012).

127 Id § 97.

known relating to the matter," and only if the consent or release "was not induced by improper conduct of the trustee."[128]

Two practical limits should be noted. First, a consent or release "by one or more of the beneficiaries of a trust ordinarily… does not preclude other beneficiaries of the trust—that is, nonconsenting present or future beneficiaries—from holding the trustee liable for a breach of trust."[129] Second, a consent or release does not protect against a subsequent breach of trust, even one involving similar conduct.[130]

VII. Remedies

The core remedies available to a beneficiary against a trustee for breach of duty come in two forms. First, a trustee is liable for surcharge in "the amount required to restore the values of the trust estate and trust distributions to what they would have been if the portion of the trust affected by the breach had been properly administered."[131] This is a make-whole measure of equitable damages. Thus, "[i]f a breach of trust causes a loss, including any failure to realize income, capital gain, or appreciation that would have resulted from proper administration of the trust, the trustee is liable for the amount necessary to compensate fully for the breach."[132]

Second, a trustee is liable for "the amount of any benefit to the trustee personally as a result of the breach."[133] A trustee that profits from a breach of trust has been unjustly enriched in the sense that all profits arising by reason of the trusteeship are presumptively trust property. Moreover, because the trustee is not entitled to keep any gains from a breach, the trustee is deterred from unilateral breach, and instead is given an incentive to disclose the potential gains and seek the beneficiary's consent.

These two core forms of relief have different remedial purposes, and a beneficiary may be entitled to both.[134] A beneficiary is also entitled to a panoply of additional remedies, including: (i) trustee removal or suspension, and the appointment of a successor or special trustee; (ii) injunctive relief to compel the trustee to perform, to enjoin a future breach, or to account; or (iii) denial of trustee compensation.[135] Moreover, on an unjust enrichment theory, a beneficiary may enforce a constructive trust or equitable lien against a third party who acquires trust property in consequence of the trustee's breach of trust, unless the third party is a good faith purchaser for value with no notice of the breach.[136]

[128] Id.; see also Unif. Trust Code § 1009 (Unif. Law Comm'n 2001).

[129] Restatement (Third) of Trusts § 97 cmt. c (Am. Law Inst. 2007).

[130] See id. cmt c(3).

[131] Id. § 100(a); see also Unif. Trust Code § 1002(a) (Unif. Law Comm'n 2001).

[132] Restatement (Third) of Trusts § 100 cmt. (b)(1) (Am. Law Inst. 2012).

[133] Id. § 100(b).

[134] See Miller v. Bank of America, N.A., 352 P.3d 1162 (N.M. 2015).

[135] See Uniform Trust Code §§ 1001 (Unif. Law Comm'n 2000).

[136] See id. §§ 1001(b)(9) and 1012; Reinhardt Univ. v. Castleberry, 734 S.E.2d 117 (Ga. Ct. App. 2012).

Perhaps the most interesting application of make-whole equitable damages concerns imprudence in the investment function. Courts once computed such damages by reference to an initial loss plus statutory interest. Today, courts are increasingly inclined to assess "what the trust likely would have earned, in the absence of the breach of trust," typically by comparison to a counterfactual prudent portfolio.[137]

Another interesting case concerns a sale of trust property to a third party in violation of a trustee's duty of loyalty. Case law, supported by the leading treatise, holds that in such circumstances the beneficiary "can set the sale aside and recover either the property itself or its value at the time of the decree, regardless of whether the trustee was authorized to sell the property to others, and regardless of whether the sale was for a fair price."[138]

Finally, recent cases have come to allow punitive damages for a trustee's "egregious" breach of trust.[139] Taking note of these cases, the Restatement identifies whether the trustee has "acted maliciously, in bad faith, or in a fraudulent, particularly reckless, or self-serving manner" as relevant factors, and also "the nature and extent of the trustee's wrongdoing, the trustee's conduct in presenting an accounting or defending a surcharge action, and the extent to which punitive damages are important in order to punish the trustee, to recognize the harm to the beneficiaries, and to deter similar misconduct."[140]

VIII. Conclusion

In functional terms, the role of fiduciary principles in trust law is to contain agency costs by inducing the trustee to act loyally and prudently in the interests of the beneficiaries in accordance with the terms of the trust. A trustee who does not comply with her fiduciary duties of loyalty and prudence, or the other subsidiary duties of trust fiduciary law, may be removed from office, and the beneficiaries will be entitled to remedies that include surcharge and disgorgement of profit. These remedies deter breach, make the trust estate and distributions whole, and prevent unjust enrichment.

In recognition of the settlor's freedom of disposition, most fiduciary principles in trust law are default rules that may be varied by the terms of the trust. However, because the fiduciary nature of trusteeship is definitional, the terms of a trust cannot negate a trustee's duty to act in good faith in the interests of the beneficiary. "A trust in which there is no legally binding obligation on a trustee is a trust in name only and more in

---

[137] Scott and Ascher on Trusts, supra note 65, § 24.9; see also Restatement (Third) of Trusts § 100 cmt. b(1).

[138] Scott and Ascher on Trusts, supra note 65, § 24.10. The leading case is In re Rothko, 372 N.E.2d 291 (N.Y. 1977).

[139] Scott and Ascher on Trusts, supra note 65, § 24.9.

[140] Restatement (Third) of Trusts § 100 cmt. d (Am. Law Inst 2012). For criticism, see Samuel L. Bray, Punitive Damages Against Trustees?, in Research Handbook on Fiduciary Law (Gordon Smith & Andrew Gold eds., 2018).

the nature of an absolute estate or fee simple grant of property."[141]

[141] McNeil v. McNeil, 798 A.2d 503, 509 (Del. 2002).