Dead Hand Investing: The Enforceability of Trust Investment Directives

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Introduction

Modern trust law must perform a delicate balancing act. On one side of the scales is the trust settlor, whose voluntary acts created and funded the trust[1] and who American law accords great deference, even in death.[2] On the other side are the trust beneficiaries, for whose benefit the trust was created and whose interests, financial and otherwise, are at stake in its administration. Trust law thus operates amid a timeless battle between the dead and the living, those who have made the rules and those who must live by them.[3]

This ongoing conflict becomes particularly evident when the settlor attempts to impose a binding investment directive, such as a mandate that a trustee retain a particular investment or pursue a particular investment philosophy. The settlor may attempt to impose such restrictions for a litany of reasons. Perhaps the settlor truly believes that his chosen investment course will maximize beneficiaries' wealth and protect the trust funds from falling prey to unproven investment strategies or unqualified portfolio managers. Perhaps the settlor has imposed the

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[1] A trust is an arrangement for the ownership of property involving three parties (or sets of parties): a "settlor" or "grantor" who conveys property to a "trustee" to be used for the benefit of one or more third party "beneficiaries." While trusts can take a variety of forms, this Article focuses on irrevocable private trusts, *viz* those trusts established for specified individual beneficiaries by a settlor who retains no power to alter or amend the trust"). For a more detailed introduction to the basics of trust law, discussing the historical background and uses of private trusts, see Jessie Dukeminier, Robert H. Sitkoff & James Lindgren, Wills, Trusts and Estates 541-557 (8th ed. 2009).

[2] For a detailed discussion of the ways in which American law honors the wishes of deceased individuals, see Ray D. Madoff, Immortality and the Law: The Rising Power of the American Dead (2010).

[3] While in many cases the settlor of an irroveocable trust will not be "dead" in a biological sense, she is functionally dead for legal purposes insofar as she lacks legal standing to amend the trust or impact its administration.

restriction as a means of perpetuating her own moral or religious beliefs. Or perhaps the settlor's motivation isn't nearly so noble. Indeed, the settlor may have imposed the restriction out of unadulterated egomania—the settlor's last effort to impose his will upon succeeding generations, cheating his own mortality by continuing to rule his descendants from the grave. Regardless of the settlor's motives, the trust beneficiaries may quickly come to view any settlor-imposed investment restrictions as inefficient and burdensome—economic shackles which unduly limit the trustees' ability to pursue the investment course that best serves the living beneficiaries and that is best suited to maximize those beneficiaries' wealth.

Trust beneficiaries seeking to set aside such settlor-imposed investment restrictions may have a new statutory tool to assist in these efforts. Section 105(b)(3) of the Uniform Trust Code (hereinafter the "UTC")[4] now codifies an unwaivable requirement that a "trust and its terms must be for the benefit of its beneficiaries" (hereinafter the "benefit-the-beneficiaries rule").[5] The Restatement (Third) of Trusts contains similar language.[6] Beneficiaries seeking to free themselves of investment restrictions now can point to these sources of authority and argue that settlor-imposed investment restrictions serve solely the dead settlor's interests and not the living beneficiaries' ones. Accordingly, goes the argument, those restrictions should be set aside.

Whether this is a correct interpretation of the benefit-the-beneficiaries rule is an open question. Whether it's a *desirable* interpretation is equally in dispute. The scholarly literature reflects a growing controversy surrounding these open questions, including a number of recent law review articles setting out opposing viewpoints on the subject.[7] I have authored two of these works while Professor John Langbein has provided a comprehensive counterpoint. In this Article, I revisit these prior works and restate my significant concerns about the benefit-the-beneficiaries rule's potential impact on trust investment law. As with my prior works, this Article is offered as guidance to judges interpreting

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[4] The UTC represents "the first national codification of the law of trusts." Unif. Trust Code prefatory note (2005). Twenty-three states plus the District of Columbia have adopted the UTC. *Legislative Fact Sheet - Trust Code*, Nat'l Conference of Comm'rs on Unif. State Laws, http://www.uniformlaws.org/LegislativeFactSheet.aspx?title=Trust%20Code (last visited June 9, 2012).

[5] The benefit-the-beneficiaries rule is codified as section 404 of the UTC, which directs that "[a] trust and its terms must be for the benefit of its beneficiaries." Unif. Trust Code § 404. Per UTC § 105(b)(3), the settlor cannot alter this mandatory rule.

[6] Restatement (Third) of Trusts § 27(2) (2003) (providing in relevant part that "a private trust, its terms, and its administration must be for the benefit of its beneficiaries.").

[7] *See infra* notes 8, 10, 19 and accompanying text.

the UTC and the Restatement and state legislators considering adoption – or modification – of state trust law. More importantly, however, this Article is intended to set out for trust settlors, beneficiaries, and their counsel the potentially significant practical implications of this ongoing academic debate.

This Article consists of three parts. In Part I, I recap the scholarly debate thus far, summarizing both my concerns relating to the benefit-the-beneficiaries rule and Professor Langbein's countervailing views. In Part II, I revisit my primary thesis, namely that the emerging rule is overbroad in its impact and would have numerous undesirable, likely unintended, effects. In Part III, I contend that the rule is counterproductive. I illustrate how trust settlors and their counsel likely would seek to avoid this emerging rule through means that would serve only to exacerbate current concerns about dead hand control of trust investments.

I. Summary of the Literature

My scholarly discourse with Professor Langbein regarding the benefit-the-beneficiaries rule was sparked by a 2004 essay in which he discussed the growing impact of mandatory rules of trust law, a noteworthy trend in a field traditionally devoted to the effectuation of settlors' intent and regulated by merely default rules of law.[8] In that essay, Professor Langbein seemingly predicted that the benefit-the-beneficiaries rule would serve to reshape trust investment law by limiting trust settlors' traditional ability to mandate specific investment guidelines for the trusts they established. Whereas trust law traditionally invalidated only those investment restrictions that "crackpot" settlors imposed, Professor Langbein predicted that such occurrences would become "more common."[9]

In a 2008 Article in the Boston University Law Review, I voiced three major reservations about this prediction.[10] First, I contended that this interpretation required a distorted reading of the UTC's text and Comments, which repeatedly cast the benefit-the-beneficiaries rule as a

8 John H. Langbein, *Mandatory Rules in the Law of Trusts*, 98 Nw. U. L. Rev. 1105 (2004) [hereinafter Langbein, *Mandatory Rules*].

9 *Id*. at 1111. ("The characteristic sphere for the application of the anti-dead-hand rule has been the fringe world of the eccentric settlor: the crackpot who wants to brick up her house, or build statues of himself, or dictate children's marital choices. In the future, however, I believe that the benefit-the-beneficiaries rule will set limits upon a more common form of settlor direction, the value-impairing investment instruction.")

10 Jeffrey A. Cooper, *Empty Promises: Settlor's Intent, the Uniform Trust Code, and the Future of Trust Investment Law*, 88 B.U. L. Rev. 1165, 1166-70 (2008) [hereinafter Cooper, *Empty Promises*]. Significant portions of this Article are excerpted from this prior work.

mere linguistic update rather than a significant departure from prior law.[11] Second, I illustrated how an expansive reading of the new rule could have unintended, overbroad consequences – interfering with the traditional role of trustee, undermining well-established estate planning techniques, and spawning meritless litigation.[12] Third, I argued that even if the drafters of the UTC did intend to modify trust law in this manner, they could not successfully do so. Rather, interstate competition to attract trust business and creative lawyering to avoid undesirable trust law would allow settlors to outflank the benefit-the-beneficiaries rule.[13] As a result, to the extent the UTC and the Restatement promised to inspire uniform mandatory rules of trust investment law, those promises ultimately would prove to be empty ones.

In early 2010, Professor Langbein published a reply to my 2008 Article in which he challenged both my interpretation of the benefit-the-beneficiaries rule and my concerns about its impact on trust investment law.[14] In his essay, Professor Langbein repeatedly sought to reassure that the benefit-the-beneficiaries rule is not "the radical and worrisome innovation that Cooper paints it to be,"[15] but rather "a modest and helpful clarification"[16] of existing trust law. Characterizing my concerns about the rule's potentially overbroad impact as "conjectural and unsound,"[17] he instead insisted that the rule is so limited in scope that it will never "play any serious role in trust practice."[18] In sum, Professor Langbein contended that the benefit-the-beneficiaries rule is but an incremental reform and that my grave reservations about its potential impact are simply unfounded.

While Professor Langbein's above-quoted passages suggested that we may have reached a middle ground, other portions of his 2010 essay suggested otherwise. Accordingly, in late 2010, I published a follow-up essay in the Boston University Law Review in which I explored what I perceived to be a continuing disconnect between Professor Langbein's

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11 *Id*. at 1178-79.

12 *Id*. at 1182-1201.

13 *Id.* at 1201-09.

14 John H. Langbein, *Burn the Rembrandt?: Trust Law's Limits on the Settlor's Power to Direct Trust Investments*, 90 B.U. L. REV. 375, 377-78 (2010) [hereinafter Langbein, *Burn the Rembrandt?*].

15 *Id.* at 396.

16 *Id.*

17 *Id*. at 397.

18 *Id*. *Cf.* Langbein, *Mandatory Rules, supra* note 8, at 1111. ("In the future, however, I believe that the benefit-the-beneficiaries rule will set limits upon a more common form of settlor direction, the value-impairing investment instruction.").

characterization of the rule and its true practical effect.[19] First, I traced the historical origins of the benefit-the-beneficiaries rule and illustrated how this rule departs from other sources of trust law far more significantly than Professor Langbein's writings have acknowledged.[20] Second, I considered the rule's potential application to a series of hypothetical trust investment directives, illustrating how Professor Langbein's proffered reading of the rule could cast a far greater shadow on trust investment law than his writings have conceded.[21]

Taken as a series, these articles outline two opposing views of the future of trust investment law. Professor Langbein casts the benefit-the-beneficiaries rule as an incremental, economically-efficient, improvement which enables trustees to serve the investment needs of beneficiaries unburdened by the foolish dictates of now-dead settlors. While not directly challenging the wisdom of this goal, my writings contend that the benefit-the-beneficiaries rule simply will fail to achieve it.[22] Trust settlors and their sage counsel simply will not yield to the benefit-the-beneficiaries regime. Its enactment will prove self-defeating, as settlors outflank this emerging rule by moving trust dollars to more settlor-friendly jurisdictions and drafting trust documents to further restrict the rights of trust beneficiaries. Dead hands will not so easily yield their power.

II. Potential Undesirable Consequences

Expansive use of the benefit-the-beneficiaries rule to invalidate trust investment directives would produce a variety of undesirable consequences, undermining well-established principles of current trust law and frustrating key aspects of modern estate planning. In this Part, I analyze six such potential consequences.

A. Undermines an Established Statutory Scheme

Reading the benefit-the-beneficiaries rule to invalidate settlor-imposed investment directives would offend a plain reading of widely-adopted trust investment statutes and undermine a well-established legal regime.

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[19] Jeffrey A. Cooper, *Shades of Gray: Applying the Benefit-the-Beneficiaries Rule to Trust Investment Directives*, 90 B.U. L. Rev. 2383 (2010) [hereinafter Cooper, *Shades of Gray*].

[20] *Id*. at 2386-95.

[21] *Id*. at 2395-2400.

[22] In the name of simplicity, I oversimplify my own position here. More precisely, I contend that a supposedly mandatory rule of intent-defeating state law, imposed by some jurisdictions and not others, is not an effective practical means of "forcing" trust settlors to relinquish dead hand control.

1. *The First Victim: The UTC Itself*

In contrast to previous codifications of trust law, which scattered fragments of governing authority across various statutes, the UTC is intended to provide a comprehensive, easily accessible source of law.[23] If the benefit-the-beneficiaries rule provides a new basis for invalidating settlor-imposed investment directives, then the UTC fails to achieve these laudable goals.

A plain reading of the UTC's text and Comments suggest that its benefit-the-beneficiaries rule serves to reiterate, rather than revolutionize, established trust law. Indeed, the actual text of the UTC, mandating that "[a] trust and its terms must be for the benefit of its beneficiaries,"[24] merely echoes traditional principles of fiduciary law.[25] The relevant Comments are equally disarming, clarifying both that the trustee's obligation towards the trust beneficiaries is to "benefit those beneficiaries in accordance with their interests *as defined in the trust's terms*,"[26] and that the settlor "has considerable latitude in specifying how a particular trust purpose is to be pursued."[27] All the UTC facially requires is that the trust terms "reasonably relate" to the trust purposes and do not deploy trust funds towards "frivolous or capricious" ends.[28] Taken together, these provisions appear to do nothing more than reiterate traditional public policy restrictions on a settlor's power.[29]

In addition to suggesting that the UTC leaves unchanged the settlor's traditional authority to define general trust terms, the drafters affirmatively state that the UTC is of particularly limited applicability in the specialized area of trust *investment* law. Specifically, neither section 105(b)(3) nor any of the other mandatory rules in section 105(b) even reference article 9 of the UTC, the article specifically related to trust

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[23] UNIF. TRUST CODE Prefatory Note (2005).

[24] *Id.* § 404.

[25] The notion that a trust exists to benefit the beneficiaries hardly appears to be a revolutionary contribution to trust law. *See* Cooper, *Empty Promises, supra* note 10, at 1171.

[26] UNIF. TRUST CODE § 404 cmt. (emphasis added). While comments to uniform acts are not binding authority, they do offer insight into the drafters' rationale, thus effectively "reflecting the legislative intent of enacting states." Edward C. Halbach, Jr. & Lawrence W. Waggoner, *The UPC's New Survivorship and Antilapse Provisions*, 55 ALB. L. REV. 1091, 1103 n.49 (1992).

[27] UNIF. TRUST CODE § 404 cmt. (citing RESTATEMENT (THIRD) OF TRUSTS § 27(2) (tent. Drft. No. 2, approved 1999)) (emphasis added).

[28] *Id.*

[29] Cooper, *Empty Promises, supra* note 10, at 1171 (indicating that courts traditionally honor settlor's intent while noting exceptions where courts invalidated trust provisions that "encouraged illegal activity, fostered immorality, or otherwise violated public policy").

investments.[30] To the contrary, the UTC's explicit approach to trust investment law is to defer[31] to the provisions of the widely-adopted Uniform Prudent Investor Act ("UPIA").[32] States that previously have adopted the UPIA are encouraged to recodify their *existing* UPIA as article 9 of the UTC,[33] while the remaining states are invited to enact the UPIA under the UTC's umbrella.[34] This deference to the existing UPIA thus represents another manner in which the UTC facially reaffirms established trust law rather than fundamentally altering it.

Taken together, these numerous provisions of the UTC seemingly grant a trust settlor the widest possible discretion[35] to define the nature of the beneficiaries' interests in a trust and to draft investment management guidelines that the settlor believes will serve those interests. An expansive application of the benefit-the-beneficiaries rule to trust investment directives would directly override the plain language of these provisions and defy their innocuous tone. This approach would render the UTC a fundamentally incomprehensible piece of trust legislation, requiring a reader seeking to understand the UTC's meaning to look to the pages of law reviews rather than the UTC's own text and Comments. If this is the unwieldy end result, then the UTC would have failed to achieve its own goals of clarity and accessibility.

2. *The Second Victim: The UPIA*

As discussed above, the emerging benefit-the-beneficiaries rule would create significant disharmony within the UTC. It also would generate unacceptable conflicts between the UTC and the UPIA, stealthily subsuming the latter Act's fundamental purpose and well-established default posture.

In order to understand the nature of the UPIA, one must first understand the prevailing theory of investment management – modern

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30 Unif. Trust Code art. 9 (2005) (incorporating the Uniform Prudent Investor Act as article 9 of the UTC).

31 David M. English, *The Uniform Trust Code (2000): Significant Provisions and Policy Issues*, 67 Mo. L. Rev. 143, 145 (2002) ("Given its importance and already widespread acceptance, the UTC does not modify the smaller Uniform Prudent Investor Act but incorporates it without change.").

32 Unif. Prudent Investor Act (1994). Forty-one states, the District of Columbia, and the U.S. Virgin Islands have adopted the UPIA. *Legislative Fact Sheet – Prudent Investor Act*, Nat'l Conference of Comm'rs on Unif. State Laws, http://www.uniformlaws.org/LegislativeFactSheet.aspx?title=Prudent%20Investor%20Act (last visited June 9, 2012).

33 Unif. Trust Code art. 9 cmt.

34 *See id.* prefatory note (stating that article 9 "provides a place for a jurisdiction to enact, reenact or codify its version of the Uniform Prudent Investor Act.").

35 The settlor's power is subject, of course, to traditional public policy limitations. *See supra* note 29.

portfolio theory.[36] Shaped by decades of investment management research, modern portfolio theory provides compelling academic support for the notion that certain investment actions, such as adequately diversifying portfolios, avoiding speculation, and minimizing investment costs, are per se prudent.[37] Six Nobel laureates have been recognized for their work related to modern portfolio theory,[38] and the UPIA incorporates the principles of modern portfolio theory.[39]

However, despite the compelling logic of modern portfolio theory, the UPIA allows individual settlors to reject it. By its own terms, the UPIA is a pure default statute, providing rules that "may be expanded, restricted, eliminated, or otherwise altered by the provisions of a trust."[40] If the UTC now adds an additional, unwaivable requirement that a settlor's exercise of this expansive discretion must objectively benefit the beneficiaries, then the UTC completely overrides the default posture of the UPIA.

The issue of portfolio diversification provides a clear example of the confusion the emerging rule would create. Under the UPIA, a trustee is directed to diversify a portfolio rather than concentrate investment risk in a small number of trust investments.[41] This general rule is subject to two major exceptions. First, the trustee is authorized to depart from the general rule whenever "the trustee reasonably determines that, because of special circumstances, the purposes of the trust are better served without diversifying."[42] Second, the requirement of diversification, like all provisions of the UPIA, is merely a default rule which the settlor may reject.[43] The emerging benefit-the-beneficiaries rule seemingly would add a major restriction to this second exception, allowing a settlor to negate the default duty to diversify only when doing so benefits the beneficiaries.

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[36] Modern portfolio theory originated with the work of Harry Markowitz. *See generally* Harry Markowitz, *Portfolio Selection*, 7 J. Fin. 77 (1952). For a brief overview of modern portfolio theory, see Martin D. Begleiter, *Does the Prudent Investor Need the Uniform Prudent Investor Act – An Empirical Study of Trust Investment Practices*, 51 Me. L. Rev. 27, 33-38 (1999); Jeffrey N. Gordon, *The Puzzling Persistence of the Constrained Prudent Man Rule*, 62 N.Y.U. L. Rev. 52, 73 n.90 (1987) (cataloging literature related to modern portfolio theory). For a more detailed guide to modern portfolio theory, see W. Scott Simon, The Prudent Investor Act: A Guide to Understanding 35-59 (Namborn Pub. Co. 2002).

[37] Simon, *supra* note 36, at 35-59.

[38] *See* Langbein, *Burn the Rembrandt?*, *supra* note 14, at 388 n.99 (listing Nobel laureates).

[39] Unif. Prudent Investor Act prefatory note (1994).

[40] *Id.* § 1(b).

[41] *Id.* § 3.

[42] *Id.*

[43] *See supra* note 40 and accompanying text.

This additional restriction completely undermines the structure of the UPIA. As noted above, the UPIA already authorizes a trustee to retain an undiversified portfolio when doing so would "better serve" the beneficiaries.[44] Therefore, the UPIA's additional verbiage unilaterally empowering the settlor to negate default investment rules has meaning only if it enables the settlor to mandate an undiversified portfolio even when the beneficiaries would be better served *by* diversifying. If the benefit-the-beneficiaries rule effectively would deny the settlor that power, it would convert the previously default duty to diversify into a mandatory one that the "circumstances" can excuse, but which the settlor cannot abrogate. That reading would undermine the UPIA's fundamental structure and would offend clear principles of statutory interpretation by rendering superfluous a portion of its text.[45]

Professor Langbein repeatedly argues against such an inflexible reading of the benefit-the-beneficiaries rule, but a detailed review of his analysis serves only to exacerbate my concerns. In his 2004 Article, for example, Langbein concedes that the benefit-the-beneficiaries rule would prevent an irrational settlor from flouting modern portfolio theory by waiving the UPIA's default provisions mandating diversification, but would allow a more thoughtful settlor truly seeking to benefit the beneficiaries to waive such provisions.[46] For example, Langbein suggests that either tax considerations or a desire to retain a family business might justify a settlor's decision to depart from the default rule.[47] These two potential exceptions are nothing new. In fact, they appear in the comments to the UPIA itself as exemplifying the type of "circumstances" which negate the *trustee's* default duty to diversify even in the absence of any directive from the settlor.[48] But what of the separate prong of the UPIA which allows a settlor to negate this default regime?[49] Professor Langbein appeared to have ignored it.

In his 2010 essay, Professor Langbein again criticized my concerns as being the product of "an extreme textualist interpretation" of the interplay between the UTC and the UPIA.[50] However, in that same essay, Professor Langbein validated my concerns by making explicit the extent to which his reading of the UTC and UPIA does undermine the

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[44] *See supra* note 42 and accompanying text.

[45] *See* TRW Inc. v. Andrews, 534 U.S. 19, 31 (2001) ("It is 'a cardinal principle of statutory construction' that 'a statute ought, upon the whole, to be so construed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void, or insignificant.'" (quoting Duncan v. Walker, 533 U.S. 167, 174 (2001))).

[46] *See* Langbein, *Mandatory Rules*, *supra* note 8, at 1111.

[47] *See id.* at 1115.

[48] Unif. Prudent Investor Act § 3 cmt. (1994).

[49] *Id.* § 1(b).

[50] Langbein, *Burn the Rembrandt?, supra* note 14, at 391.

settlor's ability to negate the default rule in favor of diversification. Specifically, Professor Langbein contended that "[t]he duty to diversify remains default law, which the UPIA authorizes the settlor to abridge in those 'special circumstances, [in which] the purposes of the trust are better served without diversifying.'"[51] Twice elsewhere in his essay, he offered largely similar formulations.[52] Professor Langbein's approach thus effectively melds the UPIA's two separate prongs into one, authorizing the settlor to trump the default duty to diversify only when "special circumstances" already made that duty inapplicable in the first place. As I had previously suggested it might,[53] Professor Langbein's formulation of the benefit-the-beneficiaries rule effectively holds the settlor to the same standard as a trustee. Default notions of prudence trump the settlor's power to define trust terms. Trust law's traditional deference to settlor's intent, and UPIA section 1(b),[54] are seemingly given no voice in this new regime.

This formulation of the benefit-the-beneficiaries rule would undermine the UPIA's established regime in areas extending well beyond questions of investment diversification. The UPIA defines all of a trustee's obligations by subjective reference to the settlor's expectations and the terms of the governing trust document.[55] The benefit-the-beneficiaries rule seemingly takes the opposite approach, allowing objective notions of prudence to circumscribe a settlor's chosen trust terms. The two approaches simply cannot be reconciled. Despite assertions to the contrary, the benefit-the-beneficiaries rule would completely undermine the UPIA's default nature, effectively limiting the settlor's power to negate default notions of prudence only when it is prudent to do so. A power to be imprudent only when prudent is no power at all.

In sum, the UTC is offered as a clear and comprehensible statute which facially defers to the UPIA's existing statutory framework for investment of trust funds. If the benefit-the-beneficiaries rule provides an

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51 *Id.* (quoting Unif. Prudent Investor Act § 3).

52 *See* Langbein, *Burn the Rembrandt?, supra* note 14, at 390. ("Like the rest of trust investment law, the duty to *diversify is a default rule. The UPIA permits a trustee to decide not to diversify but only for good reason . . . .*"); *see Id.* at 393 ("The duty to diversify has remained a default rule in the prudent investor reforms, because, despite the advantages of diversification, there are various circumstances in which a prudent fiduciary may conclude that other considerations outweigh diversification.").

53 *See* Cooper*, Empty Promises, supra* note 10, at 1181. ("Despite [Professor Langbein's] assertions to the contrary, the emerging rule would completely undermine the UPIA's default nature, effectively limiting the grantor's power to negate default notions of prudence to those cases where it is objectively prudent to do so.").

54 Unif. Prudent Investor Act § 1(b) (1994) (providing that default provisions of the UPIA "may be expanded, restricted, eliminated, or otherwise altered by the provisions of a trust)."

55 *See id.* § 2 cmt.

overriding objective standard for the enforceability of trust investment provisions, then the impact of the UTC is exactly the opposite of everything it claims to be: it fundamentally overrides one of the central provisions of the UPIA and does so in a cryptic, convoluted, manner.

B. Alters the Fiduciary Relationship

A second undesirable consequence of the benefit-the-beneficiaries rule is that it would fundamentally alter the trustee's traditional posture in trust administration matters. A trustee no longer would be interpreter and enforcer of the settlor's directives. Rather, he would become a skeptical challenger, constantly questioning the very source of authority under which he is empowered to act. This shift in roles would spawn three predictable negative effects.

First, the benefit-the-beneficiaries rule would weaken a fundamental pillar of trust law by undermining its traditional contractarian principles. In significant part, a trust document is understood to reflect a contract, "a deal, between settlor and trustee, about how the trustee will manage and apply the trust assets for the benefit of the beneficiaries."[56] This contractarian approach encourages settlors to embrace trust law by offering them greater ability to bind a trustee to follow their stated wishes.[57] The benefit-the-beneficiaries rule undermines such contractarian principles, as the trustee increasingly becomes obligated to ignore the "deal" he entered into whenever doing so would serve the objective needs of the trust beneficiaries. The change makes trust law less attractive to trust settlors and can be expected to have a chilling impact on the establishment of trusts.

For those who nevertheless proceed to establish trusts, this fundamental shift in trust law would have a second, very practical, effect: it will increase the cost of administering those trusts. The job responsibilities of trustees will markedly increase if trustees now must undertake a new obligation of evaluating the economic effect, and thus the enforceability, of every trust provision. To fulfill these new responsibilities, trustees would incur increased compliance and administrative costs – ex-

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[56] John H. Langbein, *The Contractarian Basis of the Law of Trusts*, 105 YALE L.J. 625, 652 (1995) [hereinafter Langbein, *Contractarian Basis*]. Professor Langbein's approach departed from the previously established view of trusts as primarily proprietarian in nature. For a detailed discussion of these two competing viewpoints of the nature of a trust, see Robert H. Sitkoff, *An Agency Costs Theory of Trust Law*, 89 CORNELL L. REV. 621, 627-33 (2004).

[57] *See* T.P. Gallanis, *The Trustee's Duty to Inform*, 85 N.C. L. REV. 1595, 1618-19 (2007) (contrasting a contractual approach, which gives settlors "maximum flexibility to structure the terms of the bargain with the trustee," with a proprietarian one, which is more likely to "impinge upon the wishes of the settlor in order to protect the property rights held by the beneficiary").

penses which predictably would result either in increased fees for fiduciary services or a reduction in the number of potential fiduciaries willing to serve in that capacity.[58]

In addition, this change would result in higher legal fees for routine trust administration. Typically, the lawyer who drafts a trust document also represents the trustee seeking to interpret that document.[59] This approach is not only efficient, requiring just one lawyer to serve both settlor and fiduciary, but it also likely fosters better results by providing the trustee unfettered access to the attorney-draftsman. However, if the modern regime increasingly requires that a trustee further the beneficiaries' interests *despite* the settlor's intent, it becomes ethically problematic for the attorney who represented a settlor in the drafting of a trust to also represent the trustee in administration of that trust.[60] Suddenly, we need, and must compensate, twice as many trust lawyers.[61]

In sum, the benefit-the-beneficiaries rule alters established notions of the relationship between settlors and trustees, requiring those parties

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[58] *See* Langbein, *Contractarian Basis*, *supra* note 56, at 657 (suggesting that many trustees willingly accept fiduciary roles because "compliance with trust fiduciary law is ordinarily not onerous").

[59] Joel C. Dobris, *Ethical Problems for Lawyers upon Trust Terminations: Conflicts of Interest*, 38 U. MIAMI L. REV. 1, 2 (1983). Going one step further, in many cases the draftsman actually serves as the trustee. *Cf.* ABA Comm. on Ethics & Prof'l Responsibility, Formal Op. 02-426 (2002) (concluding that a lawyer may act as both draftsman and trustee when the client has made an "informed decision" to employ the lawyer in this dual role). For a criticism of this practice, see Joseph W. deFuria, Jr., *A Matter of Ethics Ignored: The Attorney-Draftsman as Testamentary Fiduciary*, 36 U. KAN. L. REV. 275, 309 (1988) (advocating that ethical rules be modified to bar the practice). *But see* Bradley R. Cook, *New Developments Alter the Role of Estate Planners in Recommending Fiduciaries*, 16 EST. PLAN. 356, 356 (1989) (arguing that overly-strict ethical rules will put lawyers at a competitive disadvantage relative to banks and trust companies); Paula A. Monopoli, *Drafting Attorneys as Fiduciaries: Fashioning an Optimal Ethical Rule for Conflicts of Interest*, 66 U. PITT. L. REV. 411, 438 (2005) (contending that barring attorneys from acting as trustees would create a shortage of "well-trained fiduciaries").

[60] The increased risk of conflicts between settlor and trustee might prohibit an attorney from representing both parties. *See* MODEL RULES OF PROF'L CONDUCT R. 1.7(a)(2) (1983) (prohibiting representation of a client where "there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person"). Even before the emerging benefit-the-beneficiaries rule complicated the landscape, Professor Pennell called the ethical issues surrounding the representation of fiduciaries "as confused and distressing as any to be found anywhere in the estate planning practice." Jeffrey N. Pennell, *Ethics Issues: "You Can't Teach Ethics," in* 35TH ANNUAL ESTATE PLANNING INSTITUTE 657, 701 (PLI Tax Law & Est. Plan., Course Handbook Series No. 2902, 2004). For a more detailed exposition, see generally Jeffrey N. Pennell, *Representations Involving Fiduciary Entities: Who Is the Client?*, 62 FORDHAM L. REV. 1319 (1994).

[61] As one who makes his living helping to train future trust lawyers, I am not necessarily opposed to the result. However, it clearly represents a more expensive approach than the current one.

to abandon efficient rules predicated on such notions. This realignment of interests will produce a new regime that is both more cumbersome and more costly than the one it seeks to replace.

C. Opens the Floodgates of Litigation

A third undesirable consequence of the emerging benefit-the-beneficiaries rule is that it could open the proverbial floodgates of trust litigation by altering the balance of power between trust settlors and trust beneficiaries.

Even though trust law has long considered a settlor's intent to be the "polestar" of trust interpretation,[62] settlors never have enjoyed completely unfettered ability to customize the provisions of a trust.[63] For example, a trust provision intended to further an illegal or immoral purpose typically is given no effect.[64] The same is true of a trust provision which directs the waste or destruction of trust property.[65] The benefit-the-beneficiaries rule seemingly would add another category of prohibitions to this traditional list: trust provisions which are "value-impairing," or objectively imprudent.[66]

From the standpoint of trust litigation, that change could be revolutionary in two ways. First, there appears to be little demand among trust settlors to establish trusts to engage in the type of conduct that trust law has traditionally prohibited. There simply is no evidence that settlors are lining up to establish trusts to run drug cartels or oversee the wasteful destruction of property. As a result, prohibiting this conduct does little to impact the testamentary freedom of the vast majority of trust settlors. Second, the type of illegal and immoral trust provisions that trust law refuses to effectuate are not only extremely rare, but they also tend to be rather obvious.[67] Together, these factors serve to temper the volume of litigation brought by beneficiaries seeking to set aside such provisions, minimizing the judicial resources expended on adjudicating these controversies.

Adding merely imprudent trust provisions into the mix would significantly alter these historical dynamics. Consider the example of a provision directing that a closely-held family business started by one

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62 *See* Jeffrey A. Cooper, *Speak Clearly and Listen Well: Negating the Duty to Diversify Trust Investments*, 33 OHIO N.U. L. REV. 903, 903-04 (2007) (collecting authority).

63 *See* Cooper, *Empty Promises*, *supra* note 10, at 1171.

64 *Id.*

65 *See* Lior Jacob Strabilevitz, *The Right to Destroy*, 114 YALE L.J. 781, 838 (2005).

66 *See* Langbein, *Mandatory Rules*, *supra* note 8, at 1111.

67 The law already defines illegal conduct via applicable criminal statutes, while courts have long recognized our inherent ability to discern immoral conduct. *See* Jacobellis v. Ohio, 378 U.S. 184, 197 (1964) (Stewart, J., concurring) (describing hard-core pornography by saying: "I know it when I see it . . . .").

generation be continued for the next. Is this a provision common in modern trusts? It is.[68] Is it illegal or immoral? Certainly not.[69] But is it value-maximizing? Is it objectively prudent? Are the beneficiaries best served by such a provision? On such questions implicated by the emerging benefit-the-beneficiaries rule, reasonable minds can clearly disagree.

One can expect such uncertainty to foster significant fiduciary litigation. Trust beneficiaries often are a litigious bunch.[70] The emerging benefit-the-beneficiaries rule would suddenly provide beneficiaries with a new basis for seeking to overturn a settlor's estate planning regime. The question of what course of conduct would benefit the beneficiaries will be so unclear in many cases that every trust beneficiary who wished to do so could seemingly find a good-faith basis for litigation.

Since most beneficiaries settle their lawsuits rather than adjudicate the merits of their claims,[71] the benefit-the-beneficiaries rule would provide a powerful tool for a beneficiary seeking to provoke a settlement. The result is a potential dramatic expansion of nuisance lawsuits. This unwelcome trend would be compounded by the fact that the propriety of a trustee's investment decisions is a question of fact,[72] and thus a challenge on such a basis would typically survive a motion for summary judgment.

In sum, the benefit-the-beneficiaries rule would provide a powerful new arrow in the quiver of beneficiaries seeking to extort a settlement from a trustee unwilling to engage in protracted litigation. This result serves neither the needs of trust settlors nor those of society generally.

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[68] *See* Henry Christensen, III & Michael L. Graham, *100 Years Is a Long Time – New Concepts and Practical Planning Ideas*, SN025 ALI-ABA 149 (2007) (suggesting that many settlors direct the retention of closely-held assets).

[69] I assume the underlying business is a legal one.

[70] *See* Rust E. Reid et al., *Privilege and Confidentiality Issues When a Lawyer Represents a Fiduciary*, 30 REAL PROP. PROB. & TR. J. 541, 600 (1996) ("[L]itigious beneficiaries anxiously await a chance to second guess both the lawyer and the fiduciary."). Of course, some "litigious" trust beneficiaries may have valid grievances which the law should redress. *See generally* Robert Whitman & Kumar Paturi, *Improving Mechanisms for Resolving Complaints of Powerless Trust Beneficiaries*, 16 QUINNIPIAC PROB. L.J. 64 (2002) (discussing the plight of trust beneficiaries that cannot obtain the information or access to legal services needed to protect their interests). Nevertheless, as Professor Whitman and Mr. Paturi compellingly argue, such beneficiaries would be better served by streamlining and facilitating alternative forms of dispute resolution rather than fostering increased formal litigation. *Id.* at 72. See Charles W. Pieterse & Charles E. Coates, III, *Exculpation and Proaction*, SR003 ALI-ABA 141 (2009) for a detailed discussion of the use of exculpatory clauses as a means of protecting trustees from the specter of litigation.

[71] *See* Steven M. Fast, *Structuring Trusts to Avoid Beneficiary Dissatisfaction*, SG012 ALI-ABA 29 (2001).

[72] *In re* Estate of Janes, 630 N.Y.S.2d 472, 474 (Sur. Ct. 1995) (citing *In re* Clarke's Estate, 12 N.Y.2d 183, 186 (1962)).

D. Unleashes the Tyranny of the Majority

Another unsettling consequence of the benefit-the-beneficiaries rule is that it could serve to channel all trust investments into whatever investment management style is in vogue and prevent trust settlors from instituting contrary investment styles.[73] This not only undesirably narrows the universe of available investment options,[74] but may also frustrate the goals of many trust settlors.

1. *Forced to Join the Investment Herd*

Popular notions of investment management have frequently led investors to financial ruin. The stock market crashes of 1929[75] and 1987[76] both were results of euphoric public sentiment driving investment markets to unrealistic and unsustainable valuations.[77] Similar examples of this phenomenon can be found throughout world history.[78] Given the

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[73] I do not contend that proponents of the emerging rule would favor this result. Nevertheless, for the reasons discussed in this Section, I believe the rule would likely have this effect.

[74] This would undermine one of the fundamental goals of the UPIA, namely to widen the available universe of trust investments. UNIF. PRUDENT INVESTOR ACT § 2 cmt. (1994).

[75] In 1929, a dramatic crash of the U.S. stock market presaged the Great Depression. For a history of the market decline and its aftermath, see generally JOHN KENNETH GALBRAITH, THE GREAT CRASH 1929 (1997). Galbraith attributes the crash in large part to "a great speculative orgy" fueled by "a pervasive sense of confidence and optimism and conviction that ordinary people were meant to be rich." *Id.* at 169. For another account of the economic and social causes of the Great Depression, see generally MAURY KLEIN, RAINBOW'S END: THE CRASH OF 1929 (2001).

[76] On October 19, 1987, the Dow Jones Industrial Average fell 508 points, the worst one-day percentage decline in history. Lawrence J. DeMaria, *Stocks Plunge 508 Points, a Drop of 22.6%; 604 Million Volume Nearly Doubles Record*, N.Y. TIMES, Oct. 20, 1987, at A1. As was the case in 1929, the 1987 crash was a product of "a wave of reckless speculation." JOHN EHRMAN, THE EIGHTIES: AMERICA IN THE AGE OF REAGAN 114 (2005).

[77] In a prescient article, Professor Galbraith argued that the market's speculative fervor in 1987 appeared reminiscent of that seen just before the crash of 1929. John Kenneth Galbraith, *The 1929 Parallel*, ATLANTIC MONTHLY, Jan. 1987, at 62. Typifying the public sentiment preceding the 1987 crash is the fact that *The New York Times* originally solicited Galbraith's piece but ultimately rejected it as being "too alarming." JOHN KENNETH GALBRAITH, A SHORT HISTORY OF FINANCIAL EUPHORIA 9-10 (Whittle Books in assoc. with Viking 1993).

[78] For a comprehensive and entertaining look at the subject, see generally CHARLES MACKAY, EXTRAORDINARY POPULAR DELUSIONS AND THE MADNESS OF CROWDS (Harriman House 2003) (1841). In a well-timed episode for this author, as my 2008 Article was in the editing process, the U.S. stock market once again demonstrated its volatility by posting its largest one day decline since the 1987 crash, with the Dow Jones industrial falling 778 points. Vikas Bajaj & Michael M. Grynbaum, *For Stocks, Worst Single-Day Drop in Two Decades*, N.Y. TIMES, Sept. 30, 2008, at A1.

investing public's tendency towards such "irrational exuberance,"[79] many great investors have increased portfolio returns, and reduced portfolio risk, by eschewing popular investment trends and pursuing "contrarian" investment styles.[80]

The benefit-the-beneficiaries rule threatens to prohibit many contrarian investment directives, even those integral to a settlor's purpose in establishing a trust. An example will illustrate this phenomenon. Assume that it is early 2000. A sage investor has made a great fortune and decides that she has accumulated sufficient assets to support herself and several future generations of her family – enough wealth that all her trustee needs to do is preserve her accumulated assets, not continue to grow them. As such, this hypothetical settlor establishes a trust for her children and directs that the trust be invested entirely in U.S. Treasury Bills.[81] She rationalizes this investment with the thought that even in the event of a global economic meltdown, these short-term U.S. government obligations would retain their value. Her mandated investment directive thus would insulate her children from the whims of the world's financial markets and ensure they would always have funds on which to live. Through this strategy, the beneficiaries would never grow richer, but they would never suffer a catastrophic loss.

This hypothetical settlor has a clear purpose for her trust: she wants to preserve her beneficiaries' wealth rather than enhance it. In pursuit of this goal, she has imposed a precise investment restriction which directly furthers the purposes of the trust. Would a court applying the emerging benefit-the-beneficiaries rule respect this settlor's intent? The likely answer is no. Since she deviates so widely from mainstream investment sentiment, it is easy to dismiss this settlor as a fear-monger and marginalize her views as illogical and value-impairing.[82] As a result, the

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79 Alan Greenspan, then Chairman of the Federal Reserve Board, coined the phrase during a 1996 speech, musing: "[H]ow do we know when irrational exuberance has unduly escalated asset values . . . ?" *See* Richard W. Stevenson, *A Buried Message Loudly Heard*, N.Y. TIMES, Dec. 7, 1996, at 35. The words have become the most famous uttered during Greenspan's long tenure, inspiring the title of a bestselling book and becoming a catch phrase for the excessive stock market speculation of the late 1990s. ROBERT J. SHILLER, IRRATIONAL EXUBERANCE 1 (2d ed. 2005).

80 For an introduction to contrarian investing, see ANTHONY M. GALLEA & WILLIAM PATALON III, CONTRARIAN INVESTING ix (1998) (summarizing the fundamental principle of this investment approach as "sell euphoria, buy panic").

81 Because of their liquidity, short duration, and backing by the full faith and credit of the U.S. government, treasury bills are considered the safest possible investment. *See* JOHN DOWNES & JORDAN ELLIOT GOODMAN, BARRON'S FINANCE & INVESTMENT HANDBOOK 226-27 (6th ed. 2003).

82 Such was the real world experience of Maureen Allyn, chief economist at the global investment firm of Scudder, Stevens & Clark. When her firm was sold in 1998, Allyn invested her proceeds in U.S. treasuries and municipal bonds. MAGGIE MAHAR,

benefit-the-beneficiaries rule would provide a basis for ignoring these restrictions.

This result is dictated by the simple fact that few investors in the year 2000 shared our hypothetical settlor's investment vision. While our settlor wanted to keep her trust funds completely out of the stock market, the prevailing professional wisdom was that all long-term investors simply had to include stocks in their portfolios. [83] While our settlor feared a dark future for the investment markets, magazine and newspaper headlines boldly projected the Dow Jones Industrial Average[84] to grow from 11,497 on January 1, 2000[85] to 25,000 by 2010,[86] and 3,000,000 by the end of the century.[87] At a time when the nation was so enamored with the stock market that even professional reporters hinted that they would not "dare suggest" the market might be overvalued,[88] our settlor wrongly deprived her beneficiaries of the ability to pursue these further investment riches.

Given this public consensus, our settlor's restrictions would have been easy to classify as value-impairing ones.[89] The benefit-the-beneficiaries rule would have freed this settlor's trustees from these irrational

BULL!: A HISTORY OF THE BOOM, 1982-1999, 279-81, 287 (2003). Most of Allyn's contemporaries on Wall Street considered her investment decision a completely irrational one and responded "with that mixture of pity and annoyance reserved for those who fail to appreciate a New Paradigm." *Id.* at 287.

83 *See* Floyd Norris, *Toward Dow 3,000,000 and Other Millennial Ruminations*, N.Y. TIMES, Jan. 1, 2000, at C1 (reporting the prevailing market sentiment that "no long-term investor should ever get out of stocks.").

84 The Dow Jones Industrial Average, an unweighted average of thirty widely held U.S. stocks, is the "oldest and most-quoted market indicator." DOWNES & GOODMAN, *supra* note 81, at 838. See also *id.* at 837-43 for an overview of a number of other market indices.

85 Tom Petruno, *1999 Goes into the Record Book on Wall Street*, L.A. TIMES, Jan. 1, 2000, at C1.

86 *See* Manuel Schiffres, *Ladies and Gentlemen . . . Dow 25,000*, KIPLINGER'S PERS. FIN. MAG., Jan. 1, 2000, at 36. Far from attaining this lofty goal, the Dow Jones Industrial Average actually declined in value over the ensuing decade and opened for trading ten years later at a level of 10,428. Javier C. Hernandez, *A Late Slide For the Year Of the Rally*, N.Y. TIMES, Jan 1. 2010, at B1, B5.

87 Norris, *supra* note 83 at C1.

88 Joseph Nocera, *Broken Records: A Fitting Farewell to the Nasdaq Decade*, FORTUNE, Jan. 10, 2000, at 210 ("Once upon a time, we would have . . . [warned] of a speculative frenzy that couldn't possibly last. Now we don't dare suggest such a thing."). Further evidence of the prevailing investment climate of the time can be found in the fact that of over 33,000 recommendations issued by Wall Street securities analysts in 1999 to "buy," "sell," or "hold" specific stocks, only 125 were recommendations to "sell." BENJAMIN MARK COLE, THE PIED PIPERS OF WALL STREET: HOW ANALYSTS SELL YOU DOWN THE RIVER 97 (Bloomberg Press 2001).

89 A study of American financial history supports this conclusion that cautious and prudent investment strategies are frequently branded as value-impairing. *See* GAL-

investment shackles, enabling them to join the herd pursuing the ever-expanding investment bubble of 2000.[90] When that bubble burst, her chosen beneficiaries would have shared the misery of countless others as the stock market lost more than half its value in the ensuing three years.[91]

The result of this hypothetical is problematic not simply because history proved this trust settlor's fears to be justified. Rather, the concern lies in the structural inability of any trust settlor to guard against an economic or investment scenario which the mainstream of investors dismiss – a limitation that can frustrate a settlor's most basic estate planning goals. As revealed by this example, a liberal reading of the benefit-the-beneficiaries rule would invite the investment community's judgment to subsume that of the settlor, setting her trust fund on course toward a highly unlikely, but theoretically possible,[92] doomsday.[93] The

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BRAITH, *supra* note 75, at 6 (arguing that public sentiment typically marginalizes investors who express doubts about lofty market valuations).

[90] As Professor Cunningham succinctly warns: "Following the herd may seem rational and intelligent – until it stampedes straight off the cliff." LAWRENCE A. CUNNINGHAM, HOW TO THINK LIKE BENJAMIN GRAHAM AND INVEST LIKE WARREN BUFFETT 5 (2001).

[91] Floyd Norris, *Stocks Surge, Ending Streak of Six Weeks with Losses*, N.Y. TIMES, Oct. 12, 2002, at C1. The devastation could have been far worse. For example, the U.S. stock market lost 86.2% of its value during the Great Depression. *Id*. While the Depression is ancient history for many, significant stock market losses are not. On seventeen separate occasions since 1963, one of the world's financial markets has lost in excess of 50% of its value in a single year, including annual losses of 75% in Taiwan, 64% in Sweden, and 63% in the United Kingdom. SHILLER, *supra* note 79, at 134. Larger, longer-term declines have been equally prevalent in recent history. For example, Spain's stock market lost 86.6% of its value between December 1974 and December 1979, just one of some twenty recent instances in which a nation's stock market lost more than two-thirds of its value within a five-year period. *Id.* at 136.

[92] Even those professional investors who advocate contrarian investment strategies and warn against the foolishness of following popular investment sentiments can miss the point that an unprecedented market collapse remains possible, even if unlikely. As one such author emphatically argued in 1998, "Treasury bills and government bonds, gilt-edged securities for centuries, are now surefire ways to destroy your nest egg. Conversely, investments always viewed as more speculative, such as common stocks, have become outstanding vehicles to protect and enhance your capital. Yes, all the prudent rules of savings we learned at our fathers' knees are out the window." DAVID DREMAN, CONTRARIAN INVESTMENT STRATEGIES: THE NEXT GENERATION 28-29 (1998). Dreman based his analysis on historical U.S. market data, concluding that since stocks historically have outperformed government bonds, they always will. *Id.* at 305-10. Dreman's error in logic is so pervasive that the SEC requires all advertising for mutual funds to remind investors that "past performance does not guarantee future results." 17 C.F.R. § 230.482(b)(3)(i) (2009).

[93] Given my argument that objective irrationality alone should be an insufficient basis for voiding trust investment restrictions, I thus far have felt little need to defend the merits of this hypothetical settlor's decision to preserve her beneficiaries' wealth rather

prevailing wisdom of the stock market may force the trustee to do exactly what a settlor does not want him to do, undermining the fundamental purpose of a trust merely because it seems foolish to those that history may prove to be the true fools.

Trust law should claim no victory in such a result. Far from the case of the ill-advised settlor imposing a value-impairing investment restriction out of ignorance or a psychological need for control, this settlor is doing so in order to provide her beneficiaries with the safest possible source of funds. The prevailing wisdom of the market and mainstream investment theory both argue that she is being far too conservative, logic which she acknowledged but intentionally defied. Her fundamental purpose in establishing the trust thus is accorded no respect. Under the guise of seeking to benefit the beneficiaries, the tyranny of the majority[94] wrongly undermines the clear intent of this well-intentioned settlor.

2. *Repudiating Warren Buffett?*

Unfortunately, the market-wary settlor discussed in the preceding Section would not be the only type of investor potentially cast aside by the benefit-the-beneficiaries rule. Rather, the benefit-the-beneficiaries rule would frustrate any settlors who rejected prevailing market wisdom or who wished to mandate contrarian investment styles. This significant flaw in the benefit-the-beneficiaries rule is revealed by the fact that the list of investors so impacted would include the person whose name has become a synonym for investment success, Warren Buffett.

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than enhance it. However, a recent exposition on the notion of risk suggests that the settlor may be acting perfectly rationally. Given the client's vast wealth, the marginal utility of any potential investment gain is less than the disutility that would be caused by an equivalent loss. *See* PETER L. BERNSTEIN, AGAINST THE GODS: THE REMARKABLE STORY OF RISK 112 (1996) (drawing upon the work of eighteenth-century Swiss mathematician Daniel Bernoulli). As such, from a utility standpoint, the settlor is correct that her beneficiaries have more to lose by investing in stocks than they have to gain.

[94] The phrase is obviously borrowed from Alexis de Tocqueville, who warned that once majority public opinion forms in America, "there are . . . no obstacles that can . . . delay its advance, and allow it the time to hear the complaints of those it crushes as it passes. . ." ALEXIS DE TOCQUEVILLE, DEMOCRACY IN AMERICA 237 (Harvey C. Mansfield & Delba Winthrop eds. & trans., 2000). Tocqueville saw lawyers as a partial antidote to this dangerous trend, concluding that "[w]hen the American people let themselves be intoxicated by their passions or become so self-indulgent as to be carried away by their ideas, the lawyers make themselves feel an almost invisible brake that moderates and arrests them." *Id.* at 256. An undeniably astute social commentator, Tocqueville also observed that America's lawyers "form the superior political class and the most intellectual portion of society." *Id.*

Warren Buffett has been one of the country's most successful investors.[95] Between the ages of twenty-six and thirty-nine, Buffett parlayed $100 of personal funds into a $25 million investment portfolio,[96] just one step in a series of financial successes that would swell his net worth to nearly $43 billion by 2004.[97] He has justifiably become one of the most influential figures in the investment world, with his unique investment style both widely revered and frequently emulated. He is exactly the type of thoughtful, successful investor that should be the standard-bearer of modern trust investing.

Ironically, however, if a settlor tried to mandate Buffett's investment style, the benefit-the-beneficiaries rule would provide a basis to negate that provision. This perverse outcome results from the fact that Buffett's investment philosophy is the "polar opposite of modern portfolio theory,"[98] and he rejects many investment principles incorporated into the UPIA. For example, while the UPIA considers diversification a fundamental principle of modern investing,[99] Buffett generated much of his fortune through highly-concentrated investments in approximately ten companies' stocks.[100] He similarly thumbs his nose at the other "main ingredients" of modern portfolio theory, disagreeing with the prevailing view of risk, while rejecting the efficient market hypothesis.[101]

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95 A *New York Times* bestselling biography of Buffett would consider this characterization of Buffett an understatement. According to that source, Buffett is simply, "The World's Greatest Investor." ROBERT G. HAGSTROM, THE WARREN BUFFETT WAY 1 (2d ed. 2005) [hereinafter HAGSTROM, BUFFETT WAY].

96 ROBERT P. MILES, WARREN BUFFETT WEALTH: PRINCIPLES AND PRACTICAL METHODS USED BY THE WORLD'S GREATEST INVESTOR 33-34 (2004). While an impressive feat for a man under forty, this was not Buffett's first investment success. At age six, he reportedly "purchased a six-pack of Coke bottles for 25 cents and sold them individually for a nickel each, setting a lifelong benchmark of a 20 percent investment return." *Id.* at 25. At age eleven he made his first successful equity investment, buying three shares of City Service Preferred at $38 per share and selling them at $40. *Id.* at 26.

97 HAGSTROM, BUFFETT WAY, *supra* note 95, at 1.

98 ROBERT G. HAGSTROM, THE WARREN BUFFETT PORTFOLIO: MASTERING THE POWER OF THE FOCUS INVESTMENT STRATEGY 31 (1999) [hereinafter HAGSTROM, BUFFETT PORTFOLIO].

99 *See supra* note 41 and accompanying text.

100 CUNNINGHAM, *supra* note 90, at 13. An example of Buffett's willingness to take concentrated risks on particular stocks can be found in the fact that between 1991 and 1997, Coca-Cola Co. stock represented between 34% and 43% of his entire investment portfolio. HAGSTROM, BUFFETT PORTFOLIO, *supra* note 98, at 61.

101 HAGSTROM, BUFFETT PORTFOLIO, *supra* note 98, at 29-35. Buffett's business partner, Charlie Munger, evidenced similar disdain for the principles of modern portfolio theory, calling them "a type of dementia I can't even classify." JANET LOWE, WARREN BUFFETT SPEAKS: WIT AND WISDOM FROM THE WORLD'S GREATEST INVESTOR 94 (1997).

Since the benefit-the-beneficiaries rule defines benefit by reference to the prevailing standards of the time, Buffett's rejection of widespread investor sentiment places him in direct conflict with this rule.[102] As such, a trust provision mandating Buffett's investment approach would be per se imprudent under the benefit-the-beneficiaries rule.

This result speaks for itself. Something is clearly wrong when an emerging rule of trust investment law repudiates "the world's greatest investor."[103]

E. Ignores Key Goals of Estate Planning

A fifth undesirable consequence of the benefit-the-beneficiaries rule results from the fact that it narrowly defines "benefit" to mean wealth maximization. This approach fails to reflect the reality that many settlors engage in estate planning and establish trusts in order to benefit their chosen beneficiaries in a variety of ways – not only financially, but also personally and perhaps even spiritually.[104] The benefit-the-beneficiaries rule threatens a settlor's ability to pursue these other worthwhile types of benefits.

1. *Personal Benefit*

Some settlors utilize trusts to achieve personal benefits for their chosen beneficiaries. For example, assume a settlor wishes to fund a trust with a valuable vacation home in order to preserve the home for the use of her two children. Such a trust of necessity requires a stringent investment restriction mandating that the residence be retained for the beneficiaries' use rather than sold.

Both traditional principles of trust law and the emerging rule would respect such an investment restriction. Traditional law would achieve this result because the restriction at issue, retention of a personal resi-

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[102] As Buffett told investors in the 1994 Annual Meeting of Berkshire Hathaway: "You can't get rich with a weather vane." LOWE, *supra* note 101, at 96.

[103] *See supra* note 95.

[104] Shelly Steiner, Note, *Incentive Conditions: The Validity of Innovative Financial Parenting by Passing Along Wealth and Values*, 40 VAL. U. L. REV. 897, 897 (2006) (contending that many settlors use trusts not only to transfer wealth to future generations, but also to "pass down their work ethic, religion, educational goals, and philanthropic values"); *see also* JAMES E. HUGHES, JR., FAMILY WEALTH – KEEPING IT IN THE FAMILY 209 (rev. & expanded ed. 2004) (observing "that a family's wealth consists of three forms of capital – human, intellectual, and financial – and that the management of the first two is the most critical to the successful preservation of a family's wealth"); John J. Scroggin, *Restraining an Inheritance Can Accomplish a Client's Objectives*, 30 EST. PLAN. 124, 124 (2003) (observing that for many clients, "[t]he pivotal goal of estate planning is to protect and preserve the family, not to protect and preserve the assets").

dence, is not even remotely illegal or immoral.[105] The benefit-the-beneficiaries rule reaches the same result through a different analysis. Per Professor Langbein, the emerging benefit-the-beneficiaries rule respects this settlor's wishes because the asset at issue – the personal residence – simply is not held for investment.[106]

While this exception to the benefit-the-beneficiaries rule initially seems to enable the type of personal planning integral to modern estate planning, it actually does not. Exempting assets "not held for investment" from analysis under the benefit-the-beneficiaries rule requires trustees to classify trust holdings into one of two categories, separating assets held for investment from those held for the beneficiaries' personal use. Yet this dichotomy is artificial. Returning to a prior example,[107] what of a settlor's directive to retain a family business? Does the settlor intend that the asset be held for investment, and thus subject it to the restrictions imposed by the benefit-the-beneficiaries rule? Or is this asset to be held for personal use, perhaps as a source of education, prestige, or employment for younger family members? While the typical settlor probably views retaining the family business as serving both investment and personal goals, the emerging regime does not adequately envision such a middle ground.

Professor Langbein seems to suggest that a middle ground does exist, arguing that the benefit-the-beneficiaries rule might exempt assets that "are not being held for investment (*or not wholly for investment*)."[108] The rule he applies, however, is very different from the one he states. For example, in considering a directive to retain a family business as a source of prestige and influence for the beneficiaries, Langbein concludes that the directive will be honored where the benefits "outweigh the superior expected investment returns of a diversified portfolio."[109] Accordingly, this provision is enforceable not because the settlor intended the asset to be held "not wholly for investment," but rather because the trustee objectively determined that any non-investment benefits outweigh their attendant economic costs.

This approach is inconsistent with the typical goals of trust settlors and is detached from the realities of modern estate planning. Some trusts are established for a variety of purposes, and a settlor may knowingly wish to impair the trust's economic performance to pursue other

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105 *See supra* note 29.

106 Langbein, *Mandatory Rules*, *supra* note 8, at 1114-15 (characterizing retention of a residence solely for the beneficiaries' personal use as "another circumstance in which an undiversified portfolio may be quite justified").

107 *See supra* note 68 and accompanying text.

108 Langbein, *Mandatory Rules*, *supra* note 8, at 1114 (emphasis added).

109 *Id*. at 1116.

ends. The benefit-the-beneficiaries rule would seemingly honor the settlor's choices only when pursuit of the settlor's non-financial goals objectively appear to be worth the economic cost. This approach simply fails to meet settlors' needs, offering them insufficient security that trust law will honor and effectuate their estate planning goals.

2. *Spiritual Benefit*

The benefit-the-beneficiaries rule similarly undermines a settlor's ability to safeguard her beneficiaries' spiritual health through restraints on trust investments. Many trust settlors are concerned not only with beneficiaries' economic wealth, but also with their personal and moral development.[110] Some settlors may turn to investment restrictions to help reinforce desired moral values. The arrangement would effectuate an unspoken quid pro quo – future generations are welcome to live off the continuing fruits of the settlor's past investments, but must do so while embracing the values which guided and constrained the settlor's accumulation of wealth.

A settlor seeking to impart such values might impose a negative restriction on the selection of trust investments – directing her fiduciaries to avoid certain companies or certain industries. Perhaps, for example, the settlor finds cigarette manufacturers to be morally repugnant and wishes to ensure that her trust beneficiaries are never tainted by an investment in such a firm. Is such a socially responsible[111] investment directive enforceable?[112] Under the benefit-the-beneficiaries rule, the

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110 See generally Joshua C. Tate, *Conditional Love: Incentive Trusts and the Inflexibility Problem*, 41 Real Prop. Prob. & Tr. J. 445 (2006) (describing settlors' use of "incentive trusts" to encourage and reward desirable behavior). *See also* sources cited *supra* note 104.

111 The term "socially responsible investing" ("SRI") refers to the process of selecting companies in which to invest based not only on business and economic factors but also after considering the social, environmental, and political impact of those companies and the products they make. Pursuing an SRI strategy typically requires an investor to avoid certain companies and industries, such as those that pollute the environment, employ questionable labor practices, or produce morally-questionable products such as alcohol and tobacco. For an overview of SRI and a brief history of its origins, see John C. Harrington, Investing with Your Conscience: How to Achieve High Returns Using Socially Responsible Investing 3-42 (1992) (tracing the SRI movement from the 1800s to the modern day). For a comprehensive modern look at SRI, including a detailed discussion of the question of the interplay between SRI and fiduciary duties, see generally Joel C. Dobris, *SRI – Shibboleth or Canard (Socially Responsible Investing, That Is)*, 42 Real Prop. Prob. & Tr. J. 755 (2008).

112 For a consideration of the reverse question of whether a trustee may engage in socially responsible investing absent the settlor's directive to do so, see Charles E. Rounds, Jr., *Social Investing, IOLTA and the Law of Trusts: The Settlor's Case Against the Political Use of Charitable and Client Funds*, 22 Loy. U. Chi. L.J. 163, 192 (1990)

answer seems to be that it is not.[113] From the standpoint of wealth accumulation, categorically abrogating one potential type of investment simply cannot financially benefit the beneficiaries.[114]

Thus, despite her personal wishes, a trust settlor must empower her trustees to profit from enterprises that foster lung cancer, water pollution, and social injustice, because that is the way to maximize the financial interests of the trust beneficiaries.[115] The result deviates from the wishes of increasing numbers of American investors,[116] while contradicting a clear international trend favoring investment in more socially responsible companies.[117]

The benefit-the-beneficiaries rule could undermine a settlor's social and political values. It also may violate her fundamental religious beliefs. For example, Islamic law (or "Shari'ah") takes traditional concepts of social investing one step further, not only prohibiting investment in traditional "sin stocks" of companies selling alcohol, tobacco, and weaponry, but also those selling pork products, financial services and entertainment, and those incurring high levels of debt.[118] An

(concluding that unauthorized socially responsible investing violates the trustee's fiduciary duties).

113 Professor Langbein has long advocated this result. *See* John H. Langbein & Richard A. Posner, *Social Investing and the Law of Trusts*, 79 MICH. L. REV. 72, 85-92 (1980) (arguing that socially responsible investing reduces diversification and increases portfolio risk).

114 Efforts to quantify the financial impact of SRI restrictions yield conflicting results. *See* RUSSELL SPARKES, SOCIALLY RESPONSIBLE INVESTMENT: A GLOBAL REVOLUTION 243-54 (2002) (demonstrating the difficulties in analyzing SRI by discussing various studies yielding divergent results). Nevertheless, it seems intuitive that an investment restriction that requires categorical avoidance of certain types of investments cannot serve to enhance returns. Proponents of SRI regularly concede this point. *See, e.g.*, HARRINGTON, *supra* note 111, at 55 (quoting a representative of the U.S. Trust Company who concluded that "[s]ome social criteria will have an impact on performance"); ELIZABETH JUDD, INVESTING WITH A SOCIAL CONSCIENCE 12 (1990) ("Everyone agrees that restricting investments to those that jibe with an investor's conscience means passing up some stellar financial opportunities . . . .").

115 For the argument that individuals seeking to maximize their investment returns actually should seek out the very stocks that SRI eschews, see, e.g., DAN AHRENS, INVESTING IN VICE: THE RECESSION-PROOF PORTFOLIO OF BOOZE, BETS, BOMBS, AND BUTTS (2004) (advocating investments in the alcohol, gambling, defense, tobacco, and adult entertainment industries).

116 *See* SPARKES, *supra* note 114, at 354-59 (detailing the significant growth in socially responsible investing in the U.S.).

117 *See id.* at 367-90 (chronicling the growth of socially responsible investing in Europe and Asia).

118 Christopher F. Richardson, *Islamic Finance Opportunities in the Oil and Gas Sector: An Introduction to an Emerging Field*, 42 TEX. INT'L L.J. 119, 125-28 (2006).

Islamic investor may wish to invest solely in "Shari'ah-compliant" companies that meet these requirements.[119]

Shari'ah-compliant restrictions often run directly counter to traditional notions of prudent trust investing. Specifically, achieving adequate diversification, a fundamental precept of prudent investing,[120] becomes a significant issue for a Shari'ah-compliant investment portfolio.[121] For example, a recent analysis found that five of the ten largest holdings in the Dow Jones Islamic Market Index, a prototypical Shari'ah-compliant portfolio, are oil companies.[122] Conversely, financial firms were almost completely excluded from this model portfolio.[123]

As is the case with socially responsible investing, little data is available to compare the performance of Shari'ah-compliant portfolios with non-compliant ones.[124] Nevertheless, to the extent these religious principles serve to restrict the available pool of potential investments, that action is likely to impede a trust's investment prospects, a notion freely

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119 *See* Mahmoud A. El-Gamal, *"Interest" and the Paradox of Contemporary Islamic Law and Finance*, 27 Fordham Int'l L.J. 108, 133 (2003).

120 *See supra* note 41 and accompanying text.

121 Rushdi Siddiqui, *Shari'ah Compliance, Performance, and Conversion: The Case of the Dow Jones Islamic Market Index*, 7 Chi. J. Int'l L. 495, 501 (2007). "[N]ot enough pure Shari'ah-compliant companies exist for a diversified portfolio." *Id.* As a result, many Islamic portfolios of necessity include a number of investments which technically violate the principles of Islamic investing. Indeed, "a little impermissibility, as interpreted by the Shari'ah scholars, is accepted . . . ." *Id.*

122 *Id.* at 512 (including Exxon Mobil Corp., BP PLC, Total S.A., Chevron Corp., and Royal Dutch Shell PLC among the "top ten" holdings of the Dow Jones Islamic Market Index). Of the 282 oil and gas companies that are part of the Dow Jones World Index, 192 meet the criteria for inclusion in the Islamic Market Index. *Id.* at 508, 511.

123 Only 28 of the 1214 financial firms in the Dow Jones World Index qualify as acceptable Islamic investments. An investor bound by Islamic principles is thus precluded from investing in approximately 98% of the world's financial services firms. Siddiqui, *supra* note 121, at 508, 511.

124 Mr. Siddiqui contends that Shari'ah-compliant portfolios perform as well as their conventional brethren. *See id.* at 512. Data provided by Dow Jones does not support this contention. The Dow Jones Islamic Market World Index generated a 4.59% annualized return for the ten-year period ending April 30, 2012. Dow Jones Islamic Market World Index, Fact Sheet (Apr. 30, 2012), *available at* http://www.djindexes.com/mdsidx/downloads/fact_info/Dow_Jones_Islamic_Market_World_Index_Fact_Sheet.pdf. The unrestricted Global Total Stock Market Index generated a 6.63% annualized return for the same period. Dow Jones Global Total Stock Market Indexes, Fact Sheet (Apr. 30, 2012), *available at* http://www.djindexes.com/mdsidx/downloads/fact_info/Dow_Jones_Global_Total_Stock_Market_Indexes_Fact_Sheet.pdf. For the 10-year period ending September 30, 2008, the unrestricted index similarly outperformed the Shari'ah-compliant one. *See* Cooper, *Empty Promises, supra* note 10, at 1195 n.140 (summarizing data).

acknowledged among Islamic investors.[125] A clause mandating Shari'ah compliance therefore could be set aside under the benefit-the-beneficiaries rule, enabling the Islamic settlor's trust funds to be invested in a manner which fundamentally violates her core religious beliefs.[126]

F. Defeats Estate Tax Planning

A final undesirable consequence of the emerging benefit-the-beneficiaries rule is that it would undermine some of the most sophisticated forms of estate tax planning. In particular, two common estate planning techniques, the Irrevocable Life Insurance Trust ("ILIT") and the Grantor Retained Annuity Trust ("GRAT"), could become largely unworkable under the emerging regime.

1. *The ILIT*

For many individuals, prudent estate planning involves making inter vivos gifts to family members in order to reduce the imposition of estate and gift taxes.[127] One asset that many individuals will give away most freely is their life insurance, particularly any term life insurance.[128] After all, life insurance proceeds are paid only after the insured's death,

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125 *See* Kathleen Pender, *Faith-Based Funds a Growing Subset of Socially Responsible Investing*, S.F. CHRON., Mar. 12, 2006, at J1 ("In the Islamic [investing] community there's a term, 'COBM,' or the cost of being Muslim.").

126 Although this is well beyond the scope of this Article, a conflict between the UTC's mandatory rule and principles of Shari'ah-compliant investing might implicate constitutional guarantees of religious freedom.

127 Inter vivos gifting is a tax-efficient form of wealth transfer for three major reasons. First, any appreciation or income generated by a gifted asset after the time of the gift inures to the donee without imposition of additional estate or gift taxation. Second, certain exemptions from the estate and gift tax apply only to lifetime gifts. *See, e.g.*, I.R.C. § 2503(b) (establishing a tax-free "annual exclusion" currently equal to $13,000 per donee). Third, the gift tax is computed on a tax-exclusive basis (i.e., the donor's funds used to pay the gift tax are not themselves subject to gift taxation), whereas the estate tax is computed on a tax-inclusive basis (i.e., the estate tax is computed on the decedent's entire estate, including the portion of the estate that will be used to pay such taxes). For an overview of these and other considerations, see RAY D. MADOFF, CORNELIA R. TENNEY, MARTIN A. HALL & LISA N. MINGOLLA, PRACTICAL GUIDE TO ESTATE PLANNING § 8.03 (2011 ed.).

128 There are two major forms of life insurance: "term" insurance and "permanent" (or "cash value") insurance. Term insurance is akin to automobile or homeowner's insurance insofar as the insured pays an annual premium each year for one year of coverage. Permanent insurance differs in that the policy actually grows in value each year. The owner of a permanent policy thus may be able to cash in that policy or borrow against its cash value in a future year. Since the donor who gives away such a policy loses access to this cash value, the decision to give away permanent insurance involves more complex planning considerations than are implicated with a gift of pure term insurance. For a brief summary of various insurance products, see LOUIS A. MEZZULLO, AN ESTATE PLANNER'S GUIDE TO LIFE INSURANCE 7-10 (2000). For a more detailed analysis of these

a time at which the insured is rather unlikely to generate any personal enjoyment from the use of the proceeds.[129] Accordingly, while most settlors initially balk at the thought of parting with control of income-producing or business assets, life insurance gifts involve a "relative lack of pain."[130]

When transferring their life insurance, many well-advised settlors establish a trust for family members rather than making an outright gift.[131] This structure can avoid many of the administrative difficulties that arise from having insurance owned by multiple family members,[132] as well as maximize gift tax planning opportunities.[133] The specialized trust utilized to hold life insurance is known as an Irrevocable Life Insurance Trust.[134] A properly structured ILIT will enable the settlor to give away her life insurance without the imposition of any estate or gift taxation.[135]

Inherent in the decision to implement an ILIT, and reflected in the trust's name, is the settlor's expectation that the trust will own solely life insurance. However, the benefit-the-beneficiaries rule could subvert this expectation and undermine this common technique. Viewed through the narrow lens of modern portfolio theory, the investment of an entire trust portfolio in life insurance policies is no more prudent than a decision to retain an undiversified stock portfolio. As a result, even if holding a specific life insurance policy would further the settlor's

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products, see Richard A. Schwartz & Catherine R. Turner, Life Insurance Due Care: Carriers, Products, and Illustrations 165-286 (2d ed. 1994).

129 In this way, life insurance materially differs from other assets which may generate income during the settlor's life and thus would be more difficult (both economically and psychologically) for a living settlor to give away. *See* Hughes, Jr., *supra* note 104, at 97 ("In the thirty-five years I have practiced law, giving up ownership of anything is the most difficult issue my clients have faced . . . .").

130 Stephan R. Leimberg et al., The NEW New Book of Trusts 217 (3d ed. 2002).

131 *See* Robert A. Goldman, *Why Life Insurance Should Be Estate Tax Exempt*, 9 Prob. & Prop, Jan./Feb. 1995, at 30 (detailing five reasons why a gift of life insurance in trust is preferable to an outright gift).

132 *See* Mezzullo, *supra* note 128, at 37 (characterizing an ILIT as "the only way" to give life insurance efficiently to multiple beneficiaries).

133 An ILIT can be structured as a "Crummey trust," gifts to which can qualify for the $13,000 per donee annual exclusion from federal gift tax under I.R.C. § 2503(b). *See* Crummey v. Comm'r., 397 F.2d 82, 88 (9th Cir. 1968) (authorizing the technique); Estate of Cristofani v. Comm'r, 97 T.C. 74, 83-84 (1991) (reaffirming *Crummey* and expanding its scope).

134 See generally Lawrence Brody & Donald O. Jansen, The Irrevocable Life Insurance Trust: Forms with Drafting Notes (2d ed. 1999) for a detailed introduction to ILITs, including sample forms and analysis of tax consequences. *See also* Richard C. Baier, *Drafting Flexibility into an Irrevocable Life Insurance Trust*, 19 Prob. & Prop., Sept./Oct. 2005, at 62-65 (offering ILIT drafting suggestions).

135 Baier, *supra* note 134, at 65.

sole purpose in establishing the trust, a trustee seeking to comply with the benefit-the-beneficiaries rule might well feel compelled to diversify into other investments.[136]

In his 2010 essay, Professor Langbein contended that my worries about the continued viability of this estate planning technique are unfounded, but added a telling caveat by indicating that the benefit-the-beneficiaries rule would allow ILITs "when . . . deployed as part of a suitably diversified, multi-asset estate plan."[137] That additional restriction is a troubling one. In practice, many settlors implement an ILIT as their first, and often sole, inter vivos trust. These trusts arguably would not be "part of a suitably diversified, multi-asset estate plan" and thus would not meet Professor Langbein's proffered test.[138]

Under this emerging regime, a settlor would be left with two choices: keep her life insurance and expose the proceeds to transfer taxation, or gift those policies away to a trustee who might liquidate them in full or in part. Since the settlor cannot achieve what she wants – to merely re-title her life insurance policies into an ILIT – she might simply decide not to implement the ILIT at all. To the extent the settlor makes this choice, the emerging benefit-the-beneficiaries rule would have served only to expose the beneficiaries' future insurance proceeds to previously avoidable estate taxation – a bizarre "benefit" indeed.

2. *The GRAT*

The Grantor Retained Annuity Trust is one of the most attractive estate planning tools available to a wealthy settlor.[139] In this arrangement, the settlor establishes a trust for a set period of years, during which time she will receive a fixed annual annuity payment from the trust.[140] At the conclusion of the chosen term, any remaining trust assets pass to the settlor's designated beneficiaries, typically her children

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[136] At least one state legislature has addressed this concern by exempting most trust-owned life insurance policies from the UPIA's default duty to diversify. TENN. CODE ANN. § 35-14-105(c)(1)(B) (2012).

[137] Langbein, *Burn the Rembrandt?*, *supra* note 14, at 393. Professor Langbein also suggests that an ILIT could be justified based on its programmatic goals, "such as providing liquidity for survivors during estate administration and funding estate taxes." *Id*.

[138] Practicing lawyers consider this possibility a very real fear. For example, the Ohio Bar Association recently proposed a modification to Ohio law specifically to exempt ILITs from the duty to diversify. *See* James Spallino, Jr., *Drafting and Administering Irrevocable Life Insurance Trusts: The Basics and Beyond*, 20 OHIO PROB. L.J. 91, 97-98 (2009) (discussing the proposed legislation).

[139] Unlike many other sophisticated estate planning techniques, the GRAT is sanctioned by the Internal Revenue Code. *See* I.R.C. § 2702; 26 C.F.R. § 25.2702-0 to -3 (2009).

[140] *See* Steve R. Akers, *Going the Extra Mile with GRATs – Reflections on Optimal Planning Strategies*, 18 PROB. & PROP., Nov./Dec. 2004, at 24.

or a trust for their benefit.[141] The great allure of the technique is that the settlor's taxable gift to the beneficiaries is calculated based on extremely favorable valuation tables rather than on the actual performance of the trust.[142] The gift computed under these tables may be little or nothing, even though the GRAT beneficiaries ultimately may receive substantial wealth.

The following example will help illustrate the typical structure and potential tax benefits of a GRAT. Assume a settlor establishes a two-year GRAT and funds it with $1,000,000 of IBM stock. Depending on IRS interest rates in effect at the time,[143] the grantor is entitled to two annuity payments of approximately $515,000 each.[144] Since the value of the grantor's retained annuity is equal to the full amount contributed to the GRAT, there is no gift tax assessed upon the settlor,[145] and no income, gift, or estate tax imposed on any assets which may ultimately pass to the beneficiaries at the end of the term.[146]

Despite that enticing upside, there are no offsetting negative tax consequences if a GRAT suffers poor investment performance and is unable to fully satisfy the settlor's reserved annuity payments. In that case, the settlor simply takes back all the available GRAT assets and the arrangement terminates.[147] Since there is no limit to the number of GRATs a settlor may establish, the settlor would be free to simply gift the same assets to another GRAT and try again.

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141 *Id*. at 24-25.

142 *See* Lawrence P. Katzenstein, *Running the Numbers: An Economic Analysis of GRATs and QPRTs*, SM007 ALI-ABA 467 (2007) (explaining in detail the required computations).

143 The grantor's actuarial interest in a GRAT is computed based upon prevailing interest rates as reported monthly by the IRS. I.R.C. § 7520. For example, for transfers in the month of September 2011, the applicable rate was 2.0%. Rev. Proc. 2011-20, 2011-36 I.R.B. 202.

144 Utilizing the 2.0% applicable interest rate for September 2011, Rev. Proc. 2011-20, 2011-36 I.R.B. 202, a settlor seeking to minimize the gift tax consequences of a GRAT would retain an annual annuity of $515,039.10. These figures were calculated using estate planning software. Brentmark Software, Inc., *Estate Planning Tools*, (Mar. 30, 2011), http://www.brentmark.com/estateplanning.htm (results on file with author).

145 If the settlor retains an annuity equal in value to the initial GRAT corpus, the gift tax value of the remainder interest is zero. As a result, the settlor owes no gift tax upon creating and funding such a "zeroed-out" GRAT. This approach has been validated by the Tax Court. *See* Walton v. Comm'r, 115 T.C. 589, 602 (2000), *acq.* I.R.S. Notice 2003-72, 2003-44 I.R.B. 964.

146 Akers, *supra* note 140, at 25.

147 David J. Wilfert & Martha J. Leighton, *Matching the Estate Planning Tool to the Investment Plan*, *in* ESTATE PLANNING & ADMINISTRATION 529, 567 (PLI Tax Law & Est. Plan., Course Handbook Series No. D0-0096, 2002) ("The worst that can happen with a GRAT . . . is that it does not 'work,' in which case the beneficiaries get nothing and the grantor is left with approximately what he would have had if he had done nothing.").

The settlor who decides to implement a GRAT does so in lieu of two far simpler alternatives. First, the settlor could simply retain the underlying property and dispose of it at death. Second, she could give the underlying assets directly to her chosen beneficiaries, or to trusts for their benefit, without retaining any annuity payments. The settlor who chooses a GRAT over these other alternatives does so because she wishes to achieve the best of both approaches – retaining an annuity stream from the gifted property while giving any significant appreciation thereof to her chosen beneficiaries.

Given both the grantor's estate planning goal of passing future appreciation to her chosen beneficiaries and the one-sided gift tax consequences of a GRAT, the typical logic behind GRAT investing differs significantly from that of other forms of trusts.[148] Most notably, investment volatility generally enhances the potential estate planning benefits of the technique. [149] To maximize this volatility, a GRAT portfolio typically is not diversified.[150]

Unfortunately, as logical as it may be from an estate planning and transfer tax perspective, this standard approach to GRAT investing defies modern portfolio theory and thus seemingly defies the emerging benefit-the-beneficiaries rule. As a result, the benefit-the-beneficiaries rule could effectively destroy GRATs as estate planning devices.

To see how this would happen, consider the trustee's approach to investment of the hypothetical GRAT outlined above. Typically, the trustee would retain the IBM stock gifted to the GRAT and seek to capitalize on the volatility of the undiversified portfolio.[151] Such an approach, however, is hard to defend as one that will benefit the trust beneficiaries. Specifically, the trustee must take extremely little investment risk in order to provide the settlor with her full annuity payments from the GRAT.[152] Thus, retaining the IBM stock does nothing to assist this

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148 *See* Jonathan G. Blattmachr et al., *Next Bout: Drafting and Administration to Maximize GRAT Performance*, 20 Prob. & Prop., Nov./Dec. 2006, at 20 (arguing that modern portfolio theory "does not necessarily apply . . . in the context of a GRAT").

149 *See* A. Silvana Giner, *GRITs, GRATs and GRUTs*, *in* Drafting Irrevocable Trusts in Massachusetts § 9.2h.1(b) (2005) ("[T]he GRAT strategy is most useful where assets have significant volatility . . . ."); Wilfert & Leighton, *supra* note 147, at 575 (calling volatility a "positive force" in the context of a GRAT).

150 *See* Stephen F. Lappert, *IRC Sec. 2702 – GRITs (Including Personal Residence Trusts and QPRTs), GRATs and GRUTs*, *in* 29th Annual Estate Planning Update 773, 838 (PLI Tax Law & Est. Plan., Course Handbook Series No. D0-001N, 1998) ("[I]t is recommended that GRATs be asset-specific so that the gains from one investment will not be eroded by the losses from another.").

151 *See supra* notes 1499-150 and accompanying text.

152 In order to fully satisfy the settlor's retained annuity payments, the GRAT must generate an investment return that meets or exceeds the applicable Treasury interest rate. *See supra* note 143. Accordingly, the settlor will receive maximum benefit from a GRAT

trust beneficiary.[153] From the standpoint of the future remaindermen, the trustee's approach is equally indefensible – a textbook example of investment speculation which offers the potential for a huge windfall, but increases the likelihood that these beneficiaries will receive nothing at all.[154]

Taking into account the settlor's estate tax planning goals, her opportunity to create multiple GRATs, and the favorable gift tax consequences of those GRATs, it may be perfectly logical for the trustee to retain an undiversified portfolio. Yet, a court applying the benefit-the-beneficiaries rule likely would not operate from that perspective. Rather, when the trustee must defend against a future claim brought by the remaindermen of a single unsuccessful GRAT, the benefit-the-beneficiaries rule will prompt a single question: how was retaining all that IBM stock calculated to benefit the beneficiaries of this particular trust? The trustee may well have no response.[155]

The emerging benefit-the-beneficiaries rule, therefore, requires the trustee to do something the settlor and her estate planner might well consider unthinkable: immediately sell the stock contributed to a GRAT and invest the proceeds in a diversified portfolio. While such an approach seemingly meets the dictates of the benefit-the-beneficiaries rule, it fundamentally undermines the potential effectiveness of the

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established in September 2011 as long as the GRAT portfolio earns a meager 2.0% investment return. *See supra* note 143.

153 One possible exception is that the settlor would be personally liable for any capital gains tax triggered upon the sale of the GRAT asset. This could be a material consideration in some circumstances. Richard S. Gruner, *When Worlds Collide: Tax Planning Method Patents Meet Tax Practice, Making Attorneys the Latest Patent Infringers*, 8 U. ILL. J.L. TECH. & POL'Y 33, 79 (2008).

154 An illustration will help prove the point. Assuming the hypothetical GRAT discussed in this Section averages a 5% investment return over the two-year term, the remaindermen will receive a distribution of $46,670 at the end of the term. If the GRAT investment return increases to 7%, the remaindermen will receive $78,769, an increase of 69%. Conversely, an investment return of 3% will leave the remaindermen with $15,371, a decrease of 67%. A return of 2% will leave them with nothing at all. Minor changes in investment return thus have an extremely dramatic impact on the remaindermen of a GRAT, making their trust interest uniquely sensitive to the volatility of an undiversified portfolio. There figures were calculated using estate planning software. Brentmark Software, Inc., *Estate Planning Tools*, (Mar. 30, 2011), http://www.brentmark.com/estateplanning.htm (results on file with author).

155 In his 2010 essay, Professor Langbein seemingly agreed that the Trustee's failure to diversify a GRAT should be justifiable since "there is a world of difference between the uncompensated risk resulting from the underdiversification in the IBM case, and the compensated risk found in the GRAT." Langbein, *Burn the Rembrandt?*, *supra* note 14, at 393 n.134. Professor Langbein did not, however, adequately address the question of how the emerging benefit-the-beneficiaries rule would operate to reflect this significant difference.

GRAT as a tool for minimizing estate and gift taxation. Thus, just as it did with the ILIT, the benefit-the-beneficiaries rule seriously threatens this established estate planning technique.

III. The Settlors Respond

As illustrated above, the benefit-the-beneficiaries rule's assault on dead-hand control would topple key principles of trust law and undermine the estate planning efforts of many trust settlors. However, those settlors and their estate planners have living hands, not dead ones. As a result, they can, and predictably will, respond to these undesirable changes in trust law and seek to minimize their impact. Put simply, if trust law seems calculated to reject settlors' clear wishes, then settlors will reject trust law.

In this Part, I consider a number of techniques that creative settlors and skilled estate planners will likely deploy to negate the effect of the benefit-the-beneficiaries rule. As can be said of the benefit-the-beneficiaries rule itself, these countermeasures are problematic by virtue of their imprecision, depriving settlors and beneficiaries of desirable elements of trust law in a quest to avoid the undesirable. Nevertheless, attorneys active in the field of estate planning may have little choice but to consider availing their clients of these means of negating the emerging benefit-the-beneficiaries rule. Through this two step process – emergence of a rule that fails to serve the needs of trust settlors followed by settlors predictably reacting to that rule – trust law ends up being less useful, and ultimately less relevant, than before. Unfortunately, this could be the benefit-the-beneficiaries rule's ultimate legacy.

A. The Ignorant Trustee

As discussed above, the benefit-the-beneficiaries rule could fundamentally alter the trustee's traditional role.[156] Rather than loyally following the settlor's directives, a trustee frequently would be obligated to challenge those directives and undermine the settlor's intent.

The settlor, however, is the one who chooses the trustee. This creates a problematic dynamic. A settlor concerned about the benefit-the-beneficiaries rule undermining her estate plan would have a clear incentive to select a trustee who is either too ignorant to know of the benefit-the-beneficiaries rule or too deferential to follow its dictates. The more professional the trustee and the more he understands and adheres to the benefit-the-beneficiaries rule, the less likely a future trust settlor would be to select such a trustee.

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[156] *See supra* Part II.B.

The benefit-the-beneficiaries rule thus creates exactly the wrong incentives with respect to the selection of trustees. Modern scholars have rightly expressed great concern with the inefficiencies and agency costs that result from the settlor selecting a trustee to administer the beneficiaries' funds.[157] The benefit-the-beneficiaries rule exacerbates this problem by encouraging settlors to saddle trust beneficiaries with trustees chosen not for their wisdom, but rather for their ignorance.

A settlor seeking to find such an ignorant trustee would have many options. Settlors may increasingly turn to friends or relatives to act as fiduciaries, attracted to those individuals because of their lack of professional training and limited understanding of the emerging obligations of a trustee.[158] This would put increasing amounts of trust dollars in decreasingly qualified hands, reversing the current trend toward the use of professional fiduciaries.[159] Even worse, the resulting competitive pressures may well encourage otherwise competent trustees to turn a blind eye to their emerging fiduciary duties when doing so will help appease trust settlors and secure trust business.[160]

Step one for the settlor seeking to avoid the benefit-the-beneficiaries rule thus may be to find a trustee who is too ignorant to understand it.

B. The Convenient Beneficiaries

The determination of whether an investment directive will benefit the beneficiaries necessarily depends on the identity of those beneficiaries. Accordingly, a second predictable response to the benefit-the-

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[157] *See* Sitkoff, *supra* note 56, at 663 (discussing the tensions created by the fact that the settlor chooses a trustee while the beneficiaries bear the burdens of that selection).

[158] *See* Melanie B. Leslie, *Common Law, Common Sense: Fiduciary Standards and Trustee Identity*, 27 CARDOZO L. REV. 2713, 2719 (2006) ("[Settlors] may not expect nonprofessional trustees to possess . . . an expert's knowledge of the law."); Timothy P. O'Sullivan, *Family Harmony: An All Too Frequent Casualty of the Estate Planning Process*, 8 MARQ. ELDER'S ADVISOR 253, 263 (2007) ("Family fiduciaries generally are much less informed and less diligent than experienced, competent third parties . . . ."). Trust law reinforces this trend by holding nonprofessional trustees to a lower standard of conduct than their professional counterparts. *See* UNIF. PRUDENT INVESTOR ACT § 2 cmt. (1994) ("[T]he standard for professional trustees is the standard of prudent professionals; for amateurs, it is the standard of prudent amateurs."); RESTATEMENT (THIRD) OF TRUSTS § 77(3) (2003) ("If the trustee possesses, or procured appointment by purporting to possess, special facilities or greater skill than that of a person of ordinary prudence, the trustee has a duty to use such facilities or skill.").

[159] *See* Sitkoff, *supra* note 56, at 633.

[160] *See* Joel C. Dobris, *Changes in the Role and the Form of the Trust at the New Millennium, or, We Don't Have to Think of England Anymore*, 62 ALB. L. REV. 543, 559 n.68 (1998) (noting a rumor that one new trust bank "will not hire any lawyers with prior trust experience because those lawyers are too 'fussy.'").

beneficiaries rule would be for settlors to manipulate beneficial interests in trusts, favoring beneficiaries whose interests arguably would be served by pursuing the settlor's desired investment restrictions.

This suggestion is not as extreme as it may at first appear. In many cases, a minor change in the structure of a trust will alter the impact of the benefit-the-beneficiaries rule. For example, consider a hypothetical family business which employs the settlor's three daughters, but not his son. If the settlor places company stock in separate trusts for each child, the benefit-the-beneficiaries rule militates in favor of diversifying the stock held in the son's trust. After all, the son is not involved in the business, and thus the stock owned by his trust is a mere portfolio investment. A clause directing retention of the stock in such a trust could be assailed as simply benefiting the beneficiary's sisters to the detriment of the beneficiary himself, and thus could be void under the benefit-the-beneficiaries rule.

In contrast, if the settlor establishes a single trust for all four children, three of whom are active in the business, a clause directing retention of the business appears quite different in this new context. Certainly, the duties of loyalty[161] and impartiality[162] will still require the trustee to consider the interests of the son when implementing the trust's investment policy. Yet, as long as the son's stock is commingled with his sisters', the benefit-the-beneficiaries rule is marginalized as a potential basis for selling a family business which employs three of the four trust beneficiaries. The settlor thus has an easy way around the emerging doctrine by combining these multiple trusts into one.[163]

Even where such a modest change of structure will not insulate the settlor from the benefit-the-beneficiaries rule, it may be possible to simply add additional beneficiaries to stack the deck in favor of the settlor's investment directives. For example, reconsider the example of the settlor who directs her trustees to exclude cigarette companies from the

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161 Judge Cardozo penned the classic description of a trustee's duty of loyalty: "Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior." Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928). For a more modern discussion of the duty of loyalty, see *In re* Estate of Rothko, 379 N.Y.S.2d 923, 932-52, 965-78 (Sur. Ct. 1975) (removing and surcharging fiduciaries for self-interested transactions involving the estate of the famous painter, Mark Rothko), *modified*, 392 N.Y.S.2d 870 (1st Dep't 1977), *aff'd*, 372 N.E.2d 291 (1977).

162 *See* RESTATEMENT (THIRD) OF TRUSTS § 79 (2003) ("A trustee has a duty to administer the trust in a manner that is impartial with respect to the various beneficiaries of the trust. . . .").

163 The son/beneficiary is arguably worse off than he was before the change. Since there is now one trust for all four children, it has become structurally impossible to sell "his" stock without also selling his sisters' shares.

trust portfolio as part of a "socially conscious" trust investment strategy.[164] If this settlor wants to increase the likelihood that her anti-tobacco investment restriction will survive a challenge under the benefit-the-beneficiaries rule, perhaps she should simply add the American Lung Association as a potential trust beneficiary.[165] Once the trust beneficiaries include an organization committed to the eradication of lung cancer, the settlor's bar on investment in cigarette companies becomes a provision which serves the present interests of the trust beneficiaries rather than a profit-draining relic of the settlor's dead hand.[166]

Manipulating the number and nature of trust beneficiaries, even in nominal ways, is thus a second means by which trust settlors can negate the impact of the benefit-the-beneficiaries rule. This response produces another bizarre consequence: instead of aiding trust beneficiaries, the benefit-the-beneficiaries rule would lead settlors to disenfranchise those beneficiaries by combining trusts or by adding additional beneficiaries.

C. The Desirable Jurisdiction

The UTC is intended to promote uniformity of trust law among the fifty states.[167] There are two key limits to this effort. First, state legislatures remain free to customize the Code as they see fit.[168] Second, a trust settlor, regardless of her state of domicile, has considerable ability to select which state's law will govern a specific trust.[169] Settlors thus

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164 *See supra* Part II.E.2.

165 This suggestion is not as extreme as it might seem to be. The UTC defines "beneficiary" expansively as any person having "a present or future beneficial interest in a trust, vested or contingent," without regard to the magnitude of that interest. UNIF. TRUST CODE § 103(3)(A) (2005). Accordingly, possessing even an extremely minimal or extremely contingent interest in a trust makes one a "beneficiary" thereof.

166 I admit this argument is somewhat inconsistent with my prior argument that the emerging rule is calculated to maximize beneficiaries' wealth rather than serve their other interests. *See supra* Part II.E. Certainly, a ban on investment in cigarette manufacturers does not directly serve the American Lung Association's economic interests. Nevertheless, given the organization's mission, I would expect a court to be extremely sympathetic to a trust provision designed to keep this organization from investing in, and profiting from, the manufacture and sale of such products.

167 *See* UNIF. TRUST CODE prefatory note.

168 *See, e.g.*, C. Shawn O'Donnell, Note, *Exploring the Tennessee Uniform Trust Code*, 38 U. MEM. L. REV. 489, 492-93 (2008) (observing that Tennessee customized its version of the UTC).

169 Subject to certain limits, a settlor may invoke the law of a favored jurisdiction merely by electing to do so in the governing trust document. *See infra* note 184. While most lawyers utilize the law of the settlor's domicile as a default measure, one source argues that such an approach should be considered legal malpractice. *See,* Michael J. Myers & Rollyn H. Samp, *South Dakota Trust Amendments and Economic Development: The Tort of "Negligent Trust Situs" at its Incipient Stage?*, 44 S.D. L. REV. 662, 662 (1999) (advocating recognition of a cause of action for "Negligent Trust Situs"). These two

are free to shop for the state law that best meets their needs, while state legislatures are free to customize state trust law to attract wealthy settlors and profitable trust business.

State legislatures have shown a proclivity for implementing changes that will attract trust business to their jurisdictions.[170] Whether by repealing the rule against perpetuities,[171] enhancing creditor protections,[172] or eliminating disfavored taxes,[173] state lawmakers have found ways to lure the "great river of money"[174] passing from one wealthy generation to the next. Consistent with this history, state politicians have already begun modifying or discarding unpopular provisions of the UTC,[175] precipitating yet another "race for the bottom"[176] that will likely lead some jurisdictions to legislatively reverse the emerging benefit-the-beneficiaries rule.

This concern is far from idle speculation. Indeed, for example, Ohio has already done just this, deleting the mandatory rule found in UTC section 105(b)(3) and replacing the requirement in UTC section 404 that "[a] trust and its terms must be for the benefit of its beneficiaries,"[177] with a more settlor-friendly provision that "[a] trust exists,

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professors at the University of South Dakota define their proposed tort as follows: "To be ignorant of the South Dakota environment, or the failure to inform clients of its advantages . . . ." *Id.*

170 *See* Dobris, *supra* note 160, at 574 ("[A]ny change . . . which leads to the loss of trust business in big money center jurisdictions, will lead to amendments of local law in those jurisdictions.").

171 *See* Robert H. Sitkoff & Max M. Schanzenbach, *Jurisdictional Competition for Trust Funds: An Empirical Analysis of Perpetuities and Taxes*, 115 YALE L.J. 356, 359, 412-14 (2005) (discussing how states attracted wealth by repealing the rule against perpetuities).

172 *See* Stewart E. Sterk, *Asset Protection Trusts: Trust Law's Race to the Bottom?*, 85 CORNELL L. REV. 1035, 1037-38 (2000) (discussing how several states have begun to compete for trust wealth by making it easier for settlors to protect trust assets from creditors).

173 *See* Jeffrey A. Cooper, *Interstate Competition and State Death Taxes: A Modern Crisis in Historical Perspective*, 33 PEPP. L. REV. 835, 878-81 (2006) (discussing how states attracted wealth by repealing state death taxes).

174 Dobris, *supra* note 160, at 561.

175 As one example, state legislatures adopting the UTC routinely have modified the unpopular provisions requiring a trustee to keep trust beneficiaries informed regarding trust matters. Gallanis, *supra* note 57, at 1597. Also, as of Gallanis's writing, every state but one had converted that mandatory rule into a default one. *Id.* at 1609. For a more recent discussion of the same topic, see generally Philip J. Ruce, *The Trustee and the Remaindermen: The Trustee's Duty to Inform*, 46 REAL PROP. PROB. & TR. J. 173 (2011).

176 The impact of interstate competition on state laws has been studied extensively in the context of corporate law. *See, e.g.*, William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663, 666 (1974) (using the term "race for the bottom" to describe the states' efforts to attract corporate business by adopting favorable corporate laws).

177 UNIF. TRUST CODE § 404 (2005).

and its assets shall be held, for the benefit of its beneficiaries in accordance with the interests of the beneficiaries in the trust."[178] The Joint Committee recommending this Ohio modification did so with reference to Professor Langbein's 2004 essay in the *Northwestern University Law Review*, expressly rejecting the emerging benefit-the-beneficiaries rule.[179] Iowa similarly made a conscious choice not to include a mandatory benefit-the-beneficiaries rule in its version of the trust code.[180] Georgia added a unique provision affirming the settlor's power to negate the duty to diversity.[181] Most recently, New Hampshire modified its version of the UTC to clarify that the benefit-the-beneficiaries rule shall be interpreted to effectuate the settlor's intent rather than defeat it.[182] This legislative change is just one further step in New Hampshire's systematic effort to make the Granite State "the perfect place for very wealthy people to park their cash."[183]

As other state legislatures similarly pick apart the UTC to modify unpopular provisions, trust settlors will be free to select the law of the most favorable jurisdiction to govern their trust documents.[184] The re-

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178 Ohio Rev. Code Ann. § 5804.04 (LexisNexis 2012).

179 Alan Newman, *Report on HB 416: The Ohio Trust Code as Enacted* (May 2006), *available at* http://www.ohiobankersleague.com/pdf/hb416asenacted.pdf (citing Langbein, *Mandatory Rules*, *supra* note 8, at 1109).

180 *See* Martin D. Begleiter, *In the Code We Trust – Some Trust Law for Iowa at Last*, 49 Drake L. Rev. 165, 185 (2001) (discussing Iowa's decision not to include any mandatory rules in its trust code).

181 Ga. Code Ann. § 53-12-341(2) (2011) ("The trustee shall not be liable for failing to comply with the duty [to diversify] . . . to the extent that the terms of the trust instrument limit or waive the duty.")

182 New Hampshire Senate Bill 50 (S.B. 50, 2011 Sess. (N.H. 2011)), modified N.H. Rev. Stat. Ann. § 564-B:1-112 as of September 11, 2011, to provide that, "[f]or the purposes of determining the benefit of the beneficiaries, the settlor's intent as expressed in the terms of the trust shall be paramount." The bill similarly modified N.H. Rev. Stat. Ann §§ 564-B:1-105(b)(3) and 564-B:4-404 to reflect the primacy of settlor's intent in application of the benefit-the-beneficiaries rule.

183 Amy Kanyuk, *In New Hampshire We Trust*, Around Concord, at 15, 16 (Winter 2007/2008). *See also* Denis Paiste, *Banking on Trust*, N.H. Union Leader, Nov. 7, 2010 (discussing New Hampshire's efforts to attract and retain trust business); Joseph F. McDonald, III, *Migrating Trusts to New Hampshire: The "Why" and the "How,"* N.H. B. J., at 34 (Winter 2010) (discussing the mechanics of "migrating" an out-of-state trust to New Hampshire).

184 UTC § 107 provides one hurdle for a settlor seeking to adopt the law of a favorable jurisdiction. That section provides that a settlor's choice of governing law controls unless "contrary to a strong public policy of the jurisdiction having the most significant relationship to the matter at issue." Unif. Trust Code § 107 (2005). This provision creates another potential source of controversy insofar as a settlor seeking to avoid the emerging rule could freely adopt the law of a more favorable jurisdiction unless the emerging rule represents the state's strong public policy of having the "most significant relationship" to the trust. To the extent the settlor, trustee and beneficiaries have contacts with multiple states, protracted litigation might be necessary to determine (1) which

sult will be a simple means of avoiding the impact of the benefit-the-beneficiaries rule as well as creation of the very patchwork of state laws that uniform acts are intended to avoid.

D. The Avoidance of Trust Law

To this point, I have argued that trust settlors will find means *within* trust law to avoid potential implications of the benefit-the-beneficiaries rule, either by altering the provisions of trust documents or ensuring that those documents are overseen by compliant trustees or are governed by the laws of a settlor-friendly jurisdiction. There remains a final, more significant, possibility. Some trust settlors may abandon trust law in its entirety, rejecting express trusts as estate planning devices in favor of other forms of property ownership.

There are two predictable manners in which this might occur. One is through increased utilization of undocumented, "secret" trusts rather than formal ones. The other is through the use of other business entities, most likely limited partnerships or limited liability companies, as the preferred vehicles for estate planning. Widespread use of these options could sound the death knell for trust law, as settlors simply abandon a legal regime that no longer serves their needs.

1. *Informal Avoidance: Secret Trusts*

The benefit-the-beneficiaries rule might lead to the return of a device rarely seen in modern estate planning: the secret trust.[185] Returning to a prior example,[186] assume the trust settlor seeking to preserve a valuable vacation home for her children is unwilling to bear the risk that her chosen trustee will sell that property to maximize the trust's economic return. If she believes formal trust law accords insufficient deference to her chosen course of conduct, she simply may avoid that law. To do so, she could give the residence outright to her daughter, who is more emotionally attached to the house (and thus less likely to ever sell it), with the undocumented understanding that the daughter will share the house with her brother. Although the conveyance would appear to be an outright one, in reality it would be a secret trust.

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jurisdiction has the "most significant" nexus to the trust; and (2) whether the emerging rule represents the "strong public policy" of that state. For a detailed exploration of § 107, see generally Eugene F. Scoles, *Choice of Law in Trusts: Uniform Trust Code, Sections 107 and 403*, 67 MO. L. REV. 213 (2002).

[185] A secret trust is a distribution of property which appears to be an outright bequest but is really founded upon the recipient's express or implied promise to use the property to benefit another. For a complete discussion, including extensive citations to the case law, see RESTATEMENT (THIRD) OF TRUSTS § 18 (2003).

[186] *See supra* Part II.E.1.

Unfortunately the settlor's seemingly simple approach leaves crucial questions unresolved. For example, who is to resolve controversies between the siblings? What tax implications result from the ownership and use of the residence? Who will plan for the use of the house by future generations? And perhaps of greatest concern, what if the sister in our example simply denies the existence of any obligation to her brother and treats the property as solely her own?

The hypothetical settlor's reliance on a secret trust thus is fraught with peril, providing her chosen beneficiaries with neither the administrative framework nor the statutory protections afforded by formal trust law. Albeit ill-advised, her response is a predictable one which provides a simple means of avoiding a rule she considers unjust and inadvisable.[187] Ironically, while the benefit-the-beneficiaries rule is designed to protect the brother in this example from his mother's irrational vision, it actually provides an incentive for her to disenfranchise him.

2. *Formal Avoidance: Choosing Other Entities*

The investment goals of many trust settlors could be pursued through various estate planning devices, only one of which is the trust. Whether business[188] or personal assets[189] are involved, the trust competes as a form of ownership with other legal entities, including corporations, limited liability companies ("LLCs") and limited partnerships ("LPs").[190] Accordingly, a settlor seeking to arrange ownership of her assets is free to select the structure of her choice and adopt the legal regime that flows from that choice. For the settlor seeking to impose enforceable investment restrictions, LLCs and LPs (hereinafter collec-

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[187] Some may contend this prediction is too extreme. My counter is that to the extent the proponents of the emerging rule suggest that many trust investment restrictions are motivated by ego or self-aggrandizement rather than a true desire to benefit chosen beneficiaries, they should expect to encounter trust settlors who will react as I have suggested. It would be disingenuous to simultaneously argue that we need a strong benefit-the-beneficiaries rule to protect us from legions of irrational, egotistical, overly-controlling settlors and then fail to concede that some of those settlors will look to secret trusts as a means of negating the rule that seeks to constrain them.

[188] For a comparison of trusts with other entities used in commercial transactions, see, for example, Henry Hansmann et al., *The New Business Entities in Evolutionary Perspective*, 2005 U. Ill. L. Rev. 5, 5-14 (2005); John H. Langbein, *The Secret Life of the Trust: The Trust as an Instrument of Commerce*, 107 Yale L.J. 165, 179 (1997); Robert H. Sitkoff, *Trust as "Uncorporation": A Research Agenda*, 2005 U. Ill. L. Rev. 31, 35-48 (2004).

[189] *See* Louis A. Mezzullo, *Family Limited Partnerships and Limited Liability Companies*, SJ0002 ALI-ABA 615 (2003) for a comparison of trusts with other entities used in estate planning transactions.

[190] In the estate planning context, limited partnerships often are referred to as family limited partnerships ("FLPs").

tively referred to as "partnerships") now may offer a more favorable governing regime than does trust law.[191]

Like a trust, a partnership provides a mechanism to separate beneficial ownership of assets from daily management and control.[192] However, a crucial distinction is that the investment decisions made by the managing partner[193] of a partnership are evaluated based on a "business judgment" standard of conduct, a significantly more deferential standard than the "prudent investor" standard applicable to trustees.[194] In addition, the governing partnership agreement can be drafted to deter and penalize any challenges to the managing partner's investment decisions, such as by requiring those who bring unsuccessful claims against the managing partner to pay all of the resulting legal expenses.[195] Finally, a managing partner may have fewer "beneficiaries" to answer to in the first place, since the trustee's obligation to balance the investment needs of current and future beneficiaries is inapplicable in the partnership context.[196]

Utilizing a partnership to bypass undesirable elements of trust law would be a simple task for a modern estate planner. After drafting a trust for her clients' chosen beneficiaries, the lawyer would then add a second layer into the estate plan, placing her client's investment assets into a partnership and funding the trust with partnership interests rather

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[191] *See* John F. Ramsbacher, *The Family Limited Partnership/LLC – The Basic Building Block*, *in* 37TH ANNUAL ESTATE PLANNING INSTITUTE (PLI Tax Law & Est. Plan., Course Handbook Series No. 8761, 2006), for a detailed analysis of the formation, management, and uses of such entities in estate planning; David Tyler Lewis & Christopher J.C. Jones, *Limited Liability Companies as Trust Substitutes, Part 2*, 18 PROB. & PROP., Jan./Feb. 2004, at 52-56 (exploring advantages of using LLCs rather than trusts in estate planning).

[192] Both LPs and LLCs provide a means to centralize management responsibility for an entity. An LP has both "limited" and "general" partners, only the latter of which have investment responsibility and managerial control. In a manager-managed LLC, one or more members are designated as the "managers" and vested with administrative and investment responsibility. The remaining members of the LLC are akin to limited partners and have no managerial control of the entity. J. William Callison, *Venture Capital and Corporate Governance: Evolving the Limited Liability Company to Finance the Entrepreneurial Business*, 26 J. CORP. L. 97, 108 (2000).

[193] For convenience, I will use the term "managing partner" to refer generically to both the managing partner of an LP and the managing member of an LLC.

[194] S. Stacy Eastland, *I.R.C. Section 2036 Defenses for the Family Limited Partnership Technique*, SM077 ALI-ABA 1271 (2007) (discussing, at section II(3)(h) of the cited material, the distinction in standards); Mezzullo, *supra* note 189, at 726 ("This lower standard will give comfort to the older family members that the younger family members will not use 20/20 hindsight to challenge the investment decisions . . . .").

[195] *See* Eastland, *supra* note 194, at 1324.

[196] Stanley Rosenberg & Sanford J. Schlesinger, *The Benefits of Family Limited Partnerships in Estate Planning and the Impact of "Anti-Abuse" and "Check-the-Box*," N.Y. ST. B.J., 30, 33 (July-Aug. 1997).

than the underlying assets. This two-step approach would shift investment responsibility for the underlying assets from the trustee to the managing partner, who will make those decisions within the parameters of partnership law.

With this proverbial stroke of the lawyer's pen, trust investment law becomes effectively irrelevant. As a mere limited partner, the trustee has no power to impact the investment of the partnership's underlying assets. The only investment option available to the trustee would be to sell the partnership interest itself. However, this is probably not a viable option. In addition to the fact that the partnership agreement may restrict such a sale,[197] there would be almost no market for an interest in such an estate planning partnership. As a result, the trust's interest in such a partnership would trade at up to a fifty-percent discount to underlying market value,[198] likely far too high a price for the trustee to pay to regain investment control.

Due to their tax advantages and favorable legal regime, partnerships have already gained widespread acceptance in modern estate planning.[199] The emerging benefit-the-beneficiaries rule might now add one further jewel in the partnership's crown, providing a simple mechanism for avoiding the increasingly unfavorable requirements of trust law. As a result, while the trust has historically been the estate planning device of first resort, the partnership may soon assume that throne.

Conclusion

In this article, I have explored two major themes. First, the benefit-the-beneficiaries rule can be read to materially alter key principles of traditional trust law, creating significant complexities of statutory interpretation and precipitating a host of undesirable, likely unintended, consequences. Second, trust settlors and their counsel will respond to what

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[197] Mezzullo, *supra* note 189, at 645-46 (discussing specific restrictions on transferability).

[198] *See* Karen C. Burke & Grayson M.P. McCouch, *Family Limited Partnerships: Discounts, Options, and Disappearing Value*, 6 Fla. Tax Rev. 649, 650 (2004) (estimating a discount of one-third to one-half of the underlying value of the assets); Milton Childs, *Using Family Limited Partnerships for Estate Planning*, 5 Marq. Elder's Advisor 193, 198 (2004) (estimating a discount of twenty percent to fifty percent). For a detailed explanation of the applicable valuation discounts, including extensive mathematical computations, see generally Jay T. Brandi, *Estate Tax Valuation and Comparative Discounting for the Limited Liability Company Investment Fund*, J. Legal Econ., 27 (Fall 2002). For a survey of recent case law relevant to the topic, see David Pratt, *Update on Use of Family Limited Partnerships and Discount Planning*, SP037 ALI-ABA 399 (2009).

[199] Carol Warnick, *Family Limited Partnerships: Taxes, Courts, and an Uncertain Future – Part I*, 33 Colo. Law. 61, 61 (Mar. 2004) ("The family limited partnership ('FLP') has ascended to the summit of favored estate planning techniques . . . .").

they perceive as an undesirable new statutory regime in predictable ways that will serve merely to exacerbate current policy concerns about dead-hand control of trust assets. Rather than counteracting the dead hand control of trust assets, this emerging rule will force settlors towards even more extreme behavior—seeking out the most settlor-friendly trust jurisdictions and drafting the most favorable settlor-favorable trust provisions. However well-intentioned it may be, the benefit-the-beneficiaries rule thus undermines the very policy goals it was intended to further.

The future, however, does not have to be this way. The time remains for judges and legislatures to restrict the rule's application to only the most egregious of cases, leaving unfettered the discretion accorded to the vast majority of trust settlors. A trust law regime which honors the intent of trust settlors can incorporate sufficient means to protect trust beneficiaries from many misguided investment directives.[200] It cannot, however, wholly substitute its own judgment for that of trust settlors and expect those settlors to simply yield to such dictates. Dead hands will not so easily yield their power. Those who contend otherwise must realize that they have picked a battle they simply cannot win.

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[200] I discuss this theme more fully in Cooper, *Empty Promises, supra* note 10, at 1210-15.