ESSAY

SHADES OF GRAY: APPLYING THE BENEFIT-THE-BENEFICIARIES RULE TO TRUST INVESTMENT DIRECTIVES

JEFFREY A. COOPER*

INTRODUCTION

The past few years have been turbulent ones in the field of trust investment law. Some of the forces shaping the field have been impossible to ignore, such as the tumultuous financial markets that have wreaked havoc on many investment portfolios.[1] Other changes have more subtle origins, yet ultimately may prove to be of even greater significance. One such development is found

* Professor of Law, Quinnipiac University School of Law. A.B., Harvard College; J.D., Yale Law School; LL.M. (Taxation), New York University School of Law. I am grateful to Marty Begleiter, Kent Schenkel, and participants at the Faculty Forum at Quinnipiac University School of Law for their thoughtful comments regarding this work, and to Dean Brad Saxton for his financial support. I also thank Caitlin Monjeau and her colleagues at the *Boston University Law Review* for their excellent editorial work.

[1] *See generally* Floyd Norris, *For Stocks in the Developed World, it Was a Decade of Zeroes*, N.Y. TIMES, Jan. 2, 2010, at B1.

in section 105(b)(3) of the Uniform Trust Code (UTC),[2] which codifies an unwaivable requirement that a "trust and its terms must be for the benefit of its beneficiaries" (hereinafter the "benefit-the-beneficiaries rule").[3] The Restatement (Third) of Trusts contains similar language.[4]

The pages of this Law Review have chronicled a brewing controversy surrounding the benefit-the-beneficiaries rule, beginning with my 2008 article on the subject[5] and continuing with Professor John Langbein's recent counterpoint.[6] In this Essay, I revisit these two prior works, attempting to clarify the opposing viewpoints reflected therein and refocus the continuing debate over the benefit-the-beneficiaries rule and its impact on trust settlors' ability to mandate specific trust investments.

While scholarly discourse on this subject has served and will continue to serve a vital function, the ultimate impact of the benefit-the-beneficiaries rule will not be decided in the pages of law reviews. Rather, judges interpreting the UTC and the Restatement, state legislators considering adoption – or modification – of state trust law, and trust settlors and trust lawyers wrestling with the ensuing implications will be the ones to resolve this issue. Accordingly, this Essay is intended to clarify the nature of the issues confronting those various parties and inform their future decisions.

This Essay 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 efforts to respond. In Part II, I supplement the existing literature by analyzing both the historical evolution of the benefit-the-beneficiaries rule and its interaction with other established sources of trust law. In Part III, I expand upon the theme of my prior article by illustrating how the benefit-the-beneficiaries rule could have far greater impact than Professor Langbein acknowledges, or perhaps even intends.

[2] The UTC represents "the first national codification of the law of trusts." UNIF. TRUST CODE prefatory note (amended 2005), 7C U.L.A. 364 (2006). Twenty-two states plus the District of Columbia have adopted the UTC. *A Few Facts About the . . . Uniform Trust Code*, NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAWS, http://www.nccusl.org/nccusl/uniformact_factsheets/uniformacts-fs-utc2000.asp (last visited Oct. 1, 2010).

[3] 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 (amended 2005), 7C U.L.A. 484. Per UTC section 105(b)(3), the settlor cannot alter this mandatory rule. *Id.* § 105(b)(3), 7C U.L.A. 428.

[4] 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"). *See also infra* Part II.A.1.

[5] 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 *Empty Promises*].

[6] 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 *Burn the Rembrandt?*].

I. STATE OF THE DEBATE

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 notable development in a field traditionally devoted to the effectuation of settlors' intent and regulated by merely default rules of law. In that essay, Professor Langbein predicted that the benefit-the-beneficiaries rule would have particularized impact in the sphere of 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."[7]

In a 2008 article in the *Boston University Law Review*, I voiced three major reservations about this prediction. First, I contended that the UTC's text and Comments did not adequately reflect this potential effect of the benefit-the-beneficiaries rule, as the Comments repeatedly disavowed any intention to reshape trust investment law.[8] Second, I illustrated how the rule could have unintended, overbroad, consequences – interfering with the traditional role of trustee, undermining well-established estate planning techniques, and spawning meritless litigation.[9] Third, I argued that even if the drafters of the UTC did intend to modify trust law in this manner, they could not do so successfully. 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.[10] As a result, to the extent the UTC and the Restatement promised to impose rigid mandatory rules of trust investment law, those promises ultimately would prove to be empty ones.

Earlier this year, 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.[11] He defended the rule as "a modest and helpful clarification"[12] of existing law rather than "the radical and worrisome innovation that Cooper paints it to be."[13] Characterizing my concerns about the rule's potentially overbroad impact as

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[7] John H. Langbein, *Mandatory Rules in the Law of Trusts*, 98 NW. U. L. REV. 1105, 1111 (2004) [hereinafter *Mandatory Rules*] ("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.").

[8] *Empty Promises*, *supra* note 5, at 1178-79.

[9] *Id*. at 1182-1201.

[10] *Id*. at 1201-09.

[11] *Burn the Rembrandt?*, *supra* note 6, at 396.

[12] *Id.*

[13] *Id*.

"conjectural and unsound,"[14] Professor Langbein repeatedly insisted that the rule is so limited in scope that it will never "play any serious role in trust practice."[15]

As our prior writings reflect, Professor Langbein and I clearly disagree about the benefit-the-beneficiaries rule's meaning and effect. Paradoxically, we may both be right. Our difference of opinion is not so much about the wording of the rule but how it will be interpreted. A body of yet-unwritten case law ultimately will resolve our differing views, while state legislators and trust settlors will determine the ensuing implications. Only once we have seen those decisions and their resulting impact will we truly know if the rule is modest or radical, limited in scope or sweeping in effect.

In the balance of this Essay, I explore two major themes that inform my view of the rule's potential effect on established trust law. In Part II, I supplement the existing literature by exploring the origins of the benefit-the-beneficiaries rule and considering its interaction with other sources of trust law. In Part III, I consider the rule's potential application to a series of trust investment directives, illustrating how the rule could cast a far greater shadow on trust investment law than Professor Langbein suggests.

II. CONFLICTING AUTHORITY

Professor Langbein asserts that the benefit-the-beneficiaries rule is simply a modern version of a rule invalidating trusts established for "capricious purposes," a timeless element of trust law.[16] He repeatedly denies that the benefit-the-beneficiaries rule is anything more than a mere linguistic update – a "modest and helpful clarification"[17] of a "long-established"[18] pillar of trust law. This characterization is significantly misleading. Rather than a simple update of a single rule of trust law, the benefit-the-beneficiaries rule is a distinctly modern doctrine that combines selected strands of multiple traditional rules of trust law. Historically, these multiple rules were subject to far more significant limitations, and interacted in far more complex ways, than Professor Langbein suggests.

A. *The Restatement of Trusts*

As reflected in the Restatement of Trusts, multiple doctrines of American trust law impact the enforceability of mandatory investment directives. In this section, I explore the interplay among these various rules.

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[14] *Id*. at 397.

[15] *Id*.

[16] *Id*. at 395 ("[T]he benefit-the-beneficiaries rule does nothing more than clarify the old rule against capricious purposes.").

[17] *Id*. at 396.

[18] *Id*. at 376.

1. Two Rules Against Capricious Purposes

Professor Langbein casts the benefit-the-beneficiaries rule as the modern successor to the rule against capricious purposes.[19] Citing examples found in the Restatement of Trusts, he contends that this rule against capricious purposes would serve to invalidate trusts that "provide that money shall be thrown into the sea, that a field shall be sowed with salt, [or] that a house shall be boarded up and remain unoccupied . . . ."[20] Explaining the rationale for invalidating these trusts, he contends that the settlor who attempts to impose such provisions "is manifestly not acting in the interests of the beneficiaries, and that is the reason why trust law will not enforce the settlor's direction."[21]

While Professor Langbein's analysis is factually correct, it makes a significant intellectual leap and oversimplifies a far more complex history. In fact, the rule against capricious purposes to which he refers is really an amalgam of two intellectually distinct bodies of case law, both addressing allegedly capricious purposes but in very different contexts and subject to different limitations. The first line of cases addresses the enforceability of honorary or purpose trusts that lacked specified beneficiaries.[22] The second line applies the rule that nullifies trust provisions that violate public policy.[23] The benefit-the-beneficiaries rule does not merely clarify the results emerging from these two lines of cases; it significantly expands their scope.

In this section, I attempt to disentangle these two historically distinct categories of capricious purposes cases, illustrating both how Professor Langbein glosses over key intellectual distinctions among these precedents and how the benefit-the- beneficiaries rule would significantly expand their scope.

a. *Honorary Trusts*

Professor Langbein begins his defense of the rule against capricious purposes with a citation to section 47 of the Restatement (Third) of Trusts.[24] That section can be traced to 1935, when the predecessor provision of the Restatement (First) of Trusts provided as follows:

> Where the owner of property transfers it upon an intended trust for a specific non-charitable purpose, and there is no definite or definitely ascertainable beneficiary designated, no trust is created; but the transferee

[19] *Id.* at 395.

[20] *Id.* at 376 (quoting RESTATEMENT (THIRD) OF TRUSTS § 47 cmt. e (2003)).

[21] *Id*. at 382.

[22] *See* RESTATEMENT (THIRD) OF TRUSTS § 47 cmt. a (providing that an "honorary" or "purpose" trust is unenforceable if its purpose is "capricious").

[23] *See id.* § 29(c) ("An intended trust or trust provision is invalid if . . . it is contrary to public policy.").

[24] *Burn the Rembrandt?, supra* note 6, at 376 n.6 (citing RESTATEMENT (THIRD) OF TRUSTS § 47 cmt. e).

> has power to apply the property to the designated purpose, unless . . . the purpose is capricious.[25]

The relevant comments clarify that where a trust settlor violates this rule against capricious purposes, **"**no trust is created, and the devisee or legatee . . . holds the property upon a resulting trust for the estate of the testator." [26] The Restatement (Second) of Trusts carried forward the same rule essentially unchanged.[27]

As set out in the First and Second Restatements, this rule governed a limited subset of capricious-purposes cases, the intellectually easy cases in which settlors sought to establish trusts to pursue manifestly foolish purposes rather than to benefit any specific beneficiaries. These cases, and the doctrine that emerged, thus shared three key elements. First, the relevant precedents all represented attempts to create honorary or purpose trusts – trusts of which the settlor had not designated any human beneficiaries.[28] Thus, directives to cast money into the ocean, sow a field with salt, or board up a house to remain vacant were unenforceable not because the intended provisions failed to benefit the designated trust beneficiaries but, rather, because there were no beneficiaries to benefit in the first place. Second, the settlors' folly impacted entire trusts. These were cases of capricious trust purposes, not capricious trust provisions. Third, the remedy for violating the rule was a resulting trust by which the settlor, or his estate, received the corpus back.[29] Beneficiaries could not invoke the rule to keep beneficial trust interests free of restrictions that they considered capricious.

Within the past decade, section 47 of the Restatement (Third) of Trusts made a significant intellectual leap, glossing over crucial distinctions between these very extreme, very easy, past cases and far more complex modern fact patterns. While the text of the Restatement tracks the logic of its predecessors,[30] the comments make a significant addition: "Furthermore, in a trust that has definite or ascertainable beneficiaries, a provision intended to allow property to be used for a capricious purpose is to that extent invalid."[31] That single sentence significantly changes the scope and effect of the

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[25] RESTATEMENT (FIRST) OF TRUSTS § 124 (1935).

[26] *Id.* cmt. g.

[27] RESTATEMENT (SECOND) OF TRUSTS § 124 (1959) ("Where the owner of property transfers it in trust for a specific non-charitable purpose, and there is no definite or definitely ascertainable beneficiary designated, no enforceable trust is created; but the transferee has power to apply the property to the designated purpose, unless . . . the purpose is capricious.").

[28] *Id.* cmt. g.

[29] *Id.*

[30] RESTATEMENT (THIRD) OF TRUSTS § 47(2) (2003) ("If the owner of property transfers it in trust for a specific noncharitable purpose and no definite or ascertainable beneficiary is designated, unless the purpose is capricious, the transferee holds the property as trustee with power . . . to apply the property to the designated purpose . . . .").

[31] RESTATEMENT (THIRD) OF TRUSTS § 47 cmt. e.

Restatement's predecessor provisions. Whereas the old rule applied solely to trusts without any designated beneficiaries, the new rule applies to trusts with "definite or ascertainable beneficiaries."[32] Whereas the old rule applied to entire trusts, the new rule can apply to an individual trust "provision."[33] Whereas the remedy for violating the old rule was a resulting trust, the new rule provides a basis for deleting specific trust provisions from an otherwise enforceable trust, allowing the beneficiaries to keep their beneficial interests while ignoring the associated "capricious" restrictions.[34] Also, under this formulation, named trust beneficiaries have a heightened incentive to challenge provisions they consider undesirable, since the result will be judicial modification rather than a resulting trust.

As discussed immediately below, this expansion may well be consistent with other general principles of trust law.[35] Even so, modern courts must realize that the types of cases underpinning Restatement section 47 were those extreme cases in which settlors sought to pursue obviously foolish ends rather than benefit specified beneficiaries. Professor Langbein grounds the benefit-the-beneficiaries rule in this rich jurisprudence without making sufficiently clear the factual and intellectual distinctions between these prior honorary trust cases and modern trust investment provisions. The Restatement (Third) of Trusts similarly leaps across the same vast chasm, relying on a single sentence in the comments to apply these prior honorary trust precedents to trusts with specified beneficiaries.

b. *Public Policy*

The Restatement (Third) of Trusts also addresses the enforceability of trust investment provisions that violate the law or offend public policy.[36] The discussion, found in section 29, provides in relevant part that "[a]n intended trust or trust provision is invalid if . . . it is contrary to public policy."[37] The comments to section 29 explore various potential violations of public policy, including that "[i]t is against public policy to enforce a trust provision that would divert distributions or administration from the interests of the beneficiaries to other purposes that are capricious or frivolous . . . ."[38] This is the Restatement's second formulation of the rule against capricious purposes.[39]

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32 *Id*.

33 *Id*.

34 *Id.*

35 *See infra* Part II.A.1.b. (discussing public policy considerations).

36 RESTATEMENT (THIRD) OF TRUSTS § 29(c).

37 *Id.* Section 72 further clarifies that a trustee is under an affirmative duty not to comply with a trust provision if the trustee "knows or should know" that such provision violates public policy. *Id.* § 72.

38 RESTATEMENT (THIRD) OF TRUSTS § 29 cmt. m (2003). For a related formulation, see RESTATEMENT (THIRD) OF TRUSTS § 27(2) ("[A] private trust, its terms, and its administration must be for the benefit of its beneficiaries . . . ."). Section 27 is derived from section 59 of the Restatement (Second) of Trusts, which provided simply that "[a] trust can

To the extent the benefit-the-beneficiaries rule is grounded in such notions of public policy, it is subject to corresponding limitations. Specifically, prior case law reveals that courts applied this public policy exception quite narrowly. For example, consider *Colonial Trust v. Brown*,[40] which Professor Langbein calls "the leading American case" on the enforceability of trust investment restrictions.[41] In *Colonial Trust*, the court invalidated a trust provision prohibiting the construction of any building more than three stories high on certain commercial property held in trust.[42] However, before doing so, the court explored the potential impact on the broader public and concluded that enforcing the provision would materially impair the development of an entire neighborhood.[43] Balancing the settlor's traditional ability to restrict trust

be created for any purpose which is not illegal." RESTATEMENT (SECOND) OF TRUSTS § 59 (1959).

[39] Overlap between the honorary trust cases, discussed *supra* Part II.A.1.a, and the public policy considerations discussed in this Part, II.A.1.b, has muddied the case law for over a century. For example, Professor Langbein properly cites *M'Caig v. Univ. of Glasgow*, (1907) S.C.(H.L.) 231 (Sess.) (Scot.) as an early 'capricious purposes' case. *Burn the Rembrandt?*, *supra* note 6, at 376 n.8. In that case, the decedent's surviving sibling, Catherine, successfully claimed that her brother's testamentary directive to build statues of deceased family members did not benefit another person and thus was legally insufficient to divest her statutory rights as heir-at-law. *M'Caig*, (1907) S.C.(H.L.) at 241-42 (deciding the matter as a question of Scottish disinheritance law rather than on public policy grounds). There was, however, a second *M'Caig* case, decided when the victorious party from the first case, Catherine, died and directed that her estate also be used to build statues of family members. M'Caig's Trs. v. Kirk-Session of United Free Church of Lismore, (1915) S.C. 426, 426-27 (Sess.) (Scot.). In this second *M'Caig* case, the heir at law was unknown and named alternate beneficiaries under the decedent's will challenged the validity of the trust. *Id*. at 431. Because of this different procedural posture, this second *M'Caig* case was decided on more explicit public policy grounds. *See id*. at 434. A jurist in a subsequent case reflected upon these earlier decisions and argued that notwithstanding the different verbiage of the decisions, both effectively had been decided on public policy grounds. Aitken's Trs. v. Aitken, (1927) S.C.(H.L.) 374, 380-81 (Sess.) (Scot.).

Given this background, Professor Langbein has ample historical support for his contention that the benefit-the-beneficiaries rule is consistent with the "rationale" behind the rule against capricious purposes. *Burn the Rembrandt?*, *supra* note 6, at 377. However, as discussed *supra* Part II.A.1.a, the Restatement of Trusts effectively had perpetuated the distinction between the two *M'Caig* cases and treated honorary trusts without ascertainable beneficiaries as a distinct subset of capricious purposes cases. Rather than glossing over this historical distinction between honorary trusts and trusts with ascertainable beneficiaries, the drafters of the Third Restatement could have framed the benefit-the-beneficiaries rule as a straightforward application of public policy considerations.

[40] 135 A. 555, 565 (Conn. 1926).

[41] *Burn the Rembrandt?*, *supra* note 6, at 380.

[42] *Colonial Trust*, 135 A. at 565.

[43] *Id.* at 564 ("The effect of such conditions cannot but react disadvantageously upon neighboring properties, and . . . would carry a serious threat against the proper growth and development of the parts of the city in which the lands in question are situated.").

investments with the public good, the court concluded that "[t]he restrictions militate too strongly against the interests of the beneficiaries and the public welfare to be sustained . . . ."[44] In another case Professor Langbein cites,[45] a court voiding a directive to destroy a house similarly took into account the interests of the broader public, commenting on the house's "high architectural significance,"[46] "the pressing need of the community for dwelling units,"[47] and the fact that "[r]azing the home will depreciate adjoining property values."[48] Even in the often-cited Scottish cases dealing with settlors who directed the building of statues in their own memory,[49] judges understood such matters to require a "delicate exercise of judicial discretion,"[50] and reserved judicial intervention for those trust provisions "sufficiently contrary to public policy to warrant the Court's interference."[51]

Throughout this traditional case law, we see a theme of judicial restraint. Courts traditionally have set aside trust investment directives on public policy grounds solely when the settlor attempts to mandate a degree of "waste that 'a well-ordered society cannot tolerate.'"[52] While those rare trust provisions directing the wanton destruction of trust property will continue to represent the easy cases, courts interpreting the modern benefit-the-beneficiaries rule must consider whether more mundane directives to retain or sell certain trust assets or types of assets warrant invoking the specter of public policy. I maintain that most do not.

2. Enforceability of Mandatory Provisions

As discussed above, trust law historically has imposed limits on a settlor's ability to establish a trust for capricious purposes.[53] However, trust law also includes a powerful, potentially contradictory, provision, which requires a trustee to honor mandatory trust terms.[54] Under this rule, if a settlor mandates

[44] *Id*.

[45] Eyerman v. Mercantile Trust Co., N.A., 524 S.W.2d 210, 217 (Mo. Ct. App. 1975), *cited in Burn the Rembrandt?*, *supra* note 6, at 376 n.8.

[46] *Id*. at 213.

[47] *Id*. at 214.

[48] *Id*. The court's detailed considerations of the trust's impact on the broader public can be explained in part by the fact that the case included an allegation of nuisance, resolution of which required consideration of public impact.

[49] *See supra* note 39 and accompanying text.

[50] Aitken's Trs. v. Aitken, (1927) S.C.(H.L.) 374, 382 (Sess.) (Scot.).

[51] M'Caig's Trs. v. Kirk-Session of United Free Church of Lismore, (1915) S.C. 426, 438 (Scot.) ("Whether the act [directed by the settlor] is sufficiently contrary to public policy to warrant the Court's interference must depend on the degree to which it is against public policy.").

[52] RESTATEMENT (THIRD) OF TRUSTS § 29 cmt. m (2003) (quoting Eyerman v. Mercantile Trust Co., 524 S.W.2d 210, 217 (Mo. Ct. App. 1975)).

[53] See *supra* notes 22-23 and accompanying text.

[54] I explore this rule in greater detail in an earlier article. *See* Jeffrey A. Cooper, *Speak*

a specific investment course, the trustee is obligated to honor that directive.[55] While this rule is not absolute,[56] it nevertheless reflects American law's traditional deference to honoring settlors' intent.[57]

The Restatement (Third) of Trusts incorporates this rule into section 91, which provides generally that a trustee "has a duty to conform to the terms of the trust directing or restricting investments by the trustee."[58] However, as noted above,[59] the rule is subject to numerous limitations. First, a trustee's duty to honor the settlor's intent must yield to overarching requirements imposed by law and public policy. Second, this rule is subject to numerous cross-referenced exceptions, found in sections 66 and 76.[60] These exceptions include situations where a trust provision may be modified to address "circumstances not anticipated by the settlor,"[61] as well as restrictions resulting from the trustee's overarching duty to act with diligence and in good faith.[62] The comments to section 76 include among these restrictions the rule against capricious purposes found in section 47.[63]

A trustee's duty to follow trust investment directives thus is subject to considerable overarching limitations. However, that duty is not entirely without meaning. American trust law accordingly represents a compromise

Clearly and Listen Well: Negating the Duty to Diversify Trust Investments, 33 OHIO N.U. L. REV. 903, 910-11 (2007) [hereinafter *Speak Clearly and Listen Well*].

[55] As Professor Halbach puts it, "[u]nder general doctrine today, unless some public policy is violated, a settlor's directions or restrictions concerning the acquisition, retention, or disposition of specific investments or types of investments, or with respect to prescribed patterns of investment, are ordinarily binding on the trustee and serve to displace the normal duty of prudence in managing the affected trust assets." Edward C. Halbach, Jr., *Trust Investment Law in the Third Restatement*, 77 IOWA L. REV. 1151, 1175 (1992) (citing GEORGE GLEASON BOGERT & GEORGE TAYLOR BOGERT, THE LAW OF TRUSTS AND TRUSTEES § 680 (rev. 2d ed. 1982)); *see also* 3 AUSTIN WAKEMAN SCOTT & WILLIAM FRANKLIN FRATCHER, THE LAW OF TRUSTS §§ 164.1-167.2, 227.14 (4th ed. 1988) (outlining circumstances in which the trustee need not follow the settlor's directives).

[56] For example, the rule will not render enforceable a directive that violates law or public policy. *See supra* Part II.A.1.b.

[57] Although he frequently references decisions from English courts, Professor Langbein concedes that "English trust law is markedly more restrictive of settlor interference with beneficial title than American law." *Burn the Rembrandt?, supra* note 6, at 380-81.

[58] RESTATEMENT (THIRD) OF TRUSTS § 91(b) (2007).

[59] *See supra* Part II.A.1.

[60] RESTATEMENT (THIRD) OF TRUSTS § 76 (discussing how a trustee's fiduciary duties may override her duty to comply with trust provisions); RESTATEMENT (THIRD) OF TRUSTS § 66 (2003) (discussing that a trustee may have a duty to seek judicial modification of harmful trust terms).

[61] *Empty Promises, supra* note 5, at 1212-15 n.228 (citing RESTATEMENT (THIRD) TRUSTS, § 66(1) (2003)). I have advocated expansive use of this provision, rather than the benefit-the-beneficiaries rule, to address inefficient investment directives. *See id.*

[62] RESTATEMENT (THIRD) OF TRUSTS § 76 (2007).

[63] *Id.* § 76 cmt. b(1).

between competing demands, endeavoring to find the proper balance between the principles of honoring the settlor's intent, articulated in section 91, and the existence of outer limits on dead hand control, reflected in section 47. Case law demonstrates that courts traditionally have shaded that balance in the settlor's favor and have shown great deference to settlor-imposed investment directives.[64] Professor Langbein's formulation of the benefit-the-beneficiaries rule invites courts to be far less deferential.

Courts interpreting the benefit-the-beneficiaries rule must decide where to strike the proper balance between these competing rules of trust law. In doing so, they must realize that any expansion of the rights of beneficiaries under Restatement section 47 correspondingly reduces the power accorded trust settlors under section 91.

B. *Uniform Prudent Investor Act*

As I discussed in my prior article, the UTC was not intended to supplant existing trust investment law.[65] Indeed, state legislatures enacting the UTC are expected simply to recodify the existing Uniform Prudent Investor Act (UPIA) as Article 9 of the UTC.[66]

Although the UTC disavows any intent to revolutionize trust investment law, its language could have that effect. In my prior article, I suggested that the benefit-the-beneficiaries rule could generate considerable confusion in trust investment law, particularly as it relates to the UPIA's default rule in favor of diversified trust portfolios.[67] I pointed out that the UPIA's rule concerning investment diversification has two distinct features. First, it contains a significant exception which allows the trustee to maintain an undiversified trust portfolio if "the trustee reasonably determines that, because of special circumstances, the purposes of the trust are better served without

[64] GEORGE GLEASON BOGERT, GEORGE TAYLOR BOGERT & AMY MORRIS HESS, THE LAW OF TRUSTS & TRUSTEES § 680 (3d ed. 2000 & Supp. 2010).

[65] *Empty Promises*, *supra* note 5, at 1179.

[66] *See* UNIF. TRUST CODE prefatory note, 7C U.L.A. 368 (2006) (stating that article 9 "provides a place for a jurisdiction to enact, reenact or codify its version of the Uniform Prudent Investor Act"). Promulgated in 1994, the UPIA is a comprehensive statute governing all aspects of trust investment law. Forty-four states, the District of Columbia, and the United States Virgin Islands have adopted the UPIA or significant portions thereof. *See A Few Facts About the . . . Uniform Prudent Investor Act*, NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAWS, http://www.nccusl.org/Update/uniformact_factsheets/uniformacts-fs-upria.asp (last visited Oct. 1, 2010).

[67] UNIF. PRUDENT INVESTOR ACT § 3, 7B U.L.A. 29 (2006) ("A trustee shall diversify the investments of the trust unless the trustee reasonably determines that, because of special circumstances, the purposes of the trust are better served without diversifying."). For a brief discussion of the benefits of diversification, see *Speak Clearly and Listen Well*, *supra* note 54, at 906-10. *See also Burn the Rembrandt?*, *supra* note 6, at 388-89 (discussing diversification).

diversifying."[68] Second, the entire rule governing diversification is a mere default which, like all of the UPIA, may be "expanded, restricted, eliminated, or otherwise altered" by the settlor.[69] I argued that any reasonable interpretation of the benefit-the-beneficiaries rule needed to honor both of these exceptions, allowing the trustee to hold an undiversified portfolio either when the trustee determined "special circumstances" warranted that investment course or when the settlor had directed it.[70]

My reading of Professor Langbein's earlier writings suggested that the benefit-the-beneficiaries rule could meld these two distinct exceptions into one. I expressed this concern as follows:

> This additional restriction [that any settlor-imposed investment restriction must benefit the beneficiaries] 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. As such, 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. Since the emerging 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.[71]

Professor Langbein criticized my analysis as "an extreme textualist interpretation" of the interplay between the UTC and the UPIA.[72] However, he then proceeded to prove my larger point by melding the UPIA's two separate prongs into one. 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.'"[73] Twice elsewhere in his essay, he offered largely similar formulations.[74]

[68] UNIF. PRUDENT INVESTOR ACT § 3, 7B U.L.A. 29 (2006).

[69] *Id.* § 1(b), 7B U.L.A. at 15-16.

[70] *Empty Promises*, *supra* note 5, at 1180-81.

[71] *Id*. (internal citations omitted).

[72] *Burn the Rembrandt?*, *supra* note 6, at 391.

[73] *Id.* (quoting UNIF. PRUDENT INVESTOR ACT § 3, 7B U.L.A. at 29).

[74] *See id*. 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 . . . ."); *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.").

However, this contention – that the duty to diversify may be abridged only when justified by "special circumstances" – is a fundamental mischaracterization of the UPIA regime. The default rule in favor of diversification exempts those situations in which the trustee – not the settlor – reasonably determines that "special circumstances" justify an undiversified portfolio. A trustee who makes this determination thus is operating within the default rule, not negating it. The UPIA provision that provides that its default rules "may be expanded, restricted, eliminated, or otherwise altered" by the trust settlor is a wholly separate provision that contains neither the special circumstances verbiage nor any requirement that the settlor justify her rejection of default law.[75] Professor Langbein simply reads this additional power out of existence by suggesting that special circumstances must justify any undiversified trust portfolio, whether directed by the settlor or selected by the trustee. To the extent that the benefit-the-beneficiaries rule truly has this impact, it does exactly what I warned it might do, directly contradicting the letter and spirit of the UPIA and rendering meaningless the settlor's clear statutory power to negate default investment law.

III. UNDESIRABLE EFFECTS

A. *The Slippery Slope*

Professor Langbein observes that the predecessors of the benefit-the-beneficiaries rule traditionally have had limited impact; they were applicable solely to those extreme situations in which a settlor directs that a trustee build statues of the settlor, cast money into the ocean, or, famously, burn the settlor's Rembrandt.[76] The rule, he contends, is "old hat."[77] Its application, he reassures, will be limited to trust terms that "offend outer limits of rationality."[78]

However, as he applies the benefit-the-beneficiaries rule to a series of hypothetical trust provisions, Professor Langbein demonstrates that all might not be so simple. Indeed, when applied to specific examples, the rule proves to be far more rigid than prior trust law and insufficiently deferential to settlor-imposed investment directives. Courts applying this rule in this manner would

[75] UNIF. PRUDENT INVESTOR ACT § 1(b), 7B U.L.A. 15-16 (2006). As discussed *supra* Part II.A.1.b, all trust provisions are subject to overarching limitations, including limits imposed by public policy considerations.

[76] *Burn the Rembrandt?*, *supra* note 6, at 376 (referring to the relevant case law as "sadly entertaining but fortunately small"). The first two examples are found in the Restatement of Trusts. RESTATEMENT (THIRD) OF TRUSTS § 47 cmt. e (2003). Professor Langbein attributes the final example to Gareth Jones. *Burn the Rembrandt?*, *supra* note 6, at 378 (citing Gareth H. Jones, *The Dead Hand and the Law of Trusts*, *in* DEATH, TAXES AND FAMILY PROPERTY 119, 126 (Edward C. Halbach, Jr. ed., 1977) ("A settlor may destroy his own Rembrandt. But he cannot establish a trust and order his trustees to destroy it.")).

[77] *Id.* at 383.

[78] *Id*. at 397.

not merely root out wildly capricious purposes that "offend outer limits of rationality"[79] but would rigidly enforce a single vision of trust investing.

1. The Enron Example

In his 2004 essay, Professor Langbein posited the example of a settlor who directed that a "modest trust" for the benefit of his "otherwise destitute widow and orphans" be invested entirely in stock of the bankrupt Enron Corporation.[80] He concludes that such a trust provision is so capricious that no court would enforce it.[81]

I actually find the example far more complex than Professor Langbein does,[82] but for purposes of this Essay will leave his conclusion unchallenged. For the sake of argument, I am willing to assume that the directive to invest this hypothetical trust in Enron is unenforceable.

2. IBM Example I

Professor Langbein also offers a second hypothetical that changes the Enron hypothetical in two significant ways.[83] First, the beneficiaries are no longer destitute. Second, the issuer of the stock in question was not the bankrupt Enron but IBM, an established multinational corporation. Do these altered facts change the result? I contend that they should. After all, if the goal is simply to restrain investment directives that offend "outer limits of rationality,"[84] the distinction between profitable IBM and bankrupt Enron should be a relevant one. Professor Langbein disagrees.

Although he concedes that "the shares of bankrupt Enron are far riskier than those of the blue chip IBM,"[85] that fact does not impact Professor Langbein's analysis. Instead, he applies a bright line rule of modern portfolio theory: an undiversified portfolio is riskier than a diversified one.[86] The directive to hold stock in a single corporate entity, be it IBM or Enron, represents what modern

[79] *Id.* at 393.

[80] *Mandatory Rules*, *supra* note 7, at 1111.

[81] *Id*. at 1111-12.

[82] For example, assume that these various trust beneficiaries will qualify for governmental benefits that offset their basic living expenses. In this case, it might be a perfectly rational decision to forego the incremental benefits provided by this "modest trust" and make one concededly risky attempt to lift this family out of poverty. More fundamentally, the directive may still be enforceable even if not rationally defensible. *See supra* Part II.

[83] *Burn the Rembrandt?*, *supra* note 6, at 387.

[84] *Id*. at 397.

[85] *Id*. at 387.

[86] Modern Portfolio Theory (MPT) properly has been called "the most accepted conceptual framework for measuring return and risk of assets in a portfolio context." Robert J. Aalberts & Percy S. Poon, *The New Prudent Investor Rule and the Modern Portfolio Theory: A New Direction for Fiduciaries*, 34 AM. BUS. L.J. 39, 55 (1996). Modern trust law, including the UPIA, fully embraces the core principles of MPT.

portfolio theory calls "uncompensated risk."[87] In his analysis, Professor Langbein does not attempt to weigh the magnitude of that risk. Any uncompensated risk is seemingly too much risk under modern portfolio theory. Put another way, under-diversification is per se capricious.[88]

3. IBM Example II

In my 2008 article, I formulated an alternative version of the IBM example.[89] Rather than simply directing retention of IBM because the company was "good to him," as in Professor Langbein's hypothetical, my hypothetical settlor mandated retention because he felt he possessed unique investment insight and believed under-diversification would maximize the trust's investment return.[90] I attempted to cast this settlor as more rational and less emotional than the one in Professor Langbein's hypothetical, and further distinguished him as motivated by a desire to maximize trust investment returns rather than honor his former employer. Shouldn't these altered facts impact the analysis? Shouldn't we find it more difficult to brand this trust provision "capricious?" Professor Langbein, again, says no.

Rather than yielding to the directives of this hypothetical settlor, Professor Langbein seems dismissive. He hypothesizes that the settlor is likely motivated by "his sentimental affection for bygone days,"[91] and possesses only "primitive views on investment matters."[92] He does not suggest that we accord this hypothetical settlor any latitude or wait to see if his investment prognostications prove correct. Instead, Professor Langbein coolly states that a directive to retain a single entity's stock is "objectively foolish by the standards of the field,"[93] and "foolishness . . . is a synonym for capriciousness."[94] The analysis ends there. Sell the IBM.

[87] Under MPT, "uncompensated risk" is risk that does not produce additional investment return. *Id.* at 58.

[88] While these hypotheticals involve completely undiversified, single-asset trusts, there is no reason to believe that Professor Langbein would treat these provisions any differently if they allowed the trustee to diversify slightly into a limited number of additional investments. Indeed, Professor Langbein seems to suggest this by noting that that adequate diversification can be achieved by "a carefully constructed portfolio of approximately twenty different issues." *Burn the Rembrandt?*, *supra* note 6, at 388 n.103. Presumably, the trustee would need to diversify further into additional asset classes, such as fixed income.

[89] *Empty Promises*, *supra* note 5, at 1175.

[90] *Id*. (quoting the settlor as opining that "[t]he market fundamentally misperceives the company's business prospects and its stock is grossly undervalued").

[91] *Burn the Rembrandt?*, *supra* note 6, at 392.

[92] *Id*.

[93] *Id*.

[94] *Id*. at 387.

4. Keep the Rembrandt

Working through the prior hypotheticals, we see the potential inflexibility of the benefit-the-beneficiaries rule. Rather than simply rooting out cases of obvious caprice that "offend outer limits of rationality,"[95] Professor Langbein seems to apply the rule to set aside any investment restriction that defies modern portfolio theory and the six Nobel laureates who helped develop it.[96] In marked contrast to traditional notions of capricious trust terms and public policy considerations, there is no suggestion that Professor Langbein sees the enforceability of trust investment restrictions as involving questions of degree. Rather, he gives the impression that prudence and caprice are as easy to distinguish as black and white. Either an investment directive objectively maximizes the trust's profit potential under principles of modern portfolio theory or it is capricious. There seems to be no middle ground.

To illustrate how expansive this rule could become, I offer one final hypothetical. Suppose a trust settlor has just spent his entire fortune on a single holding he considers seriously undervalued in the current marketplace and establishes a trust to hold this solitary investment. His trustees are authorized to loan out the investment as needed to generate income, but he wants the underlying asset kept for the foreseeable future to capitalize on its appreciation potential. The investment is nothing as mundane as stock in IBM or Enron. It is an old oil painting imported from Amsterdam. The settlor's investment imperative: "Keep the Rembrandt."

What would modern portfolio theory say to this final example? I contend that the answer is clear. From the standpoint of modern portfolio theory, there is no justification for limiting an investment portfolio to a single holding – one painting – in a single asset class – artwork.[97] If courts adopt that as the relevant test under the benefit-the-beneficiaries rule, they would find this provision capricious and set it aside. The trustee holding our hypothetical artwork thus would have no choice. She must sell the Rembrandt.[98]

With this final example, we have slid to the bottom of a very slippery slope. Evaluating trust investment directives should involve questions of degree – subtle shades of gray rather than stark contrasts between black and white. Trust investment law should be flexible enough to respond to these gradations. It should find some meaningful distinction between bankrupt Enron and profitable IBM, between a whimsical trust provision and a thoughtful one,

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[95] *Id*. at 397.

[96] *Id*. at 388 n.99 (listing six Nobel laureates associated with MPT).

[97] This hypothetical settlor has directed retention of the painting solely as an investment. He has not intended any programmatic benefits, such as enabling the trust beneficiaries to display the painting in their homes.

[98] More precisely, if the mandatory provision is set aside, the trustee may keep the Rembrandt but is not required to do so. As a practical matter, however, I think that a court's invalidating the mandate to keep the Rembrandt would be tantamount to directing its sale. No trustee would be expected to elect to follow an investment directive that a court had deemed capricious.

between a mandate to safeguard a Rembrandt and a directive to destroy it. As applied by Professor Langbein, the benefit-the-beneficiaries rule seems simply incapable of making these crucial distinctions.

B. *Estate Planning Under the Rule*

The preceding examples illustrate the different approaches Professor Langbein and I would take to a series of hypothetical trust investment directives. Our differences are not limited to mere hypotheticals. Rather, we continue to disagree about the benefit-the-beneficiaries rule's potential impact on a variety of established estate planning techniques. In my previous article, I expressed particular concern that the benefit-the-beneficiaries rule could imperil two specific estate planning strategies, Irrevocable Life Insurance Trusts (ILITs) and Grantor-Retained Annuity Trusts (GRATs). Professor Langbein unsuccessfully sought to assuage my fears.

With respect to ILITs, I observed that settlors have established countless trusts for estate planning purposes that are funded solely with life insurance policies without regard for investment diversification.[99] Professor Langbein offers reassurance that my worries about the continued viability of this technique are unfounded, but adds 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."[100] 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 thus would not meet Professor Langbein's requirement that they be "part of a suitably diversified, multi-asset estate plan."[101]

With respect to GRATs, I contended that the benefit-the-beneficiaries rule threatened established principles of GRAT investing, which favor undiversified portfolios and concentrated investment risk as a means of maximizing a settlor's estate planning goals.[102] Professor Langbein again dismissed my concern, stating, "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."[103] However, beyond calling

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99 *Empty Promises*, *supra* note 5, at 1196-98.

100 *Burn the Rembrandt?*, *supra* note 6, 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*.

101 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 PROB. L.J. OF OHIO 91, 97-98 (2009) (discussing the proposed legislation).

102 *Empty Promises*, *supra* note 5, at 1198-1201.

103 *Burn the Rembrandt?*, *supra* note 6, at 393 n.134. Professor Langbein also references the GRAT's "tax-saving" potential, *id.*, an apparent allusion to the comments to UPIA section 3, which provide that tax considerations may impact the default duty to diversify,

my concern "odd[],"[104] Professor Langbein offers no explanation of why a GRAT's investment risk would be considered "compensated risk," or why a rule that evaluates trust investment restrictions based on their "benefit" to beneficiaries would not effectively destroy this estate planning technique that relies on increased portfolio volatility as a tool to achieve a settlor's estate planning goals.[105]

While Professor Langbein seeks to reassure settlors of GRATs and ILITs that the benefit-the-beneficiaries rule will not scuttle their estate plans, I remain unconvinced. The rule on its face can be applied to such trusts, and the fiduciary of those trusts would be hard pressed to document how undiversified trust portfolios served to maximize the beneficiaries' economic interests rather than blindly implement the settlor's estate planning goals. I maintain that an expansive reading of the benefit-the-beneficiaries rule could have significant, and likely unintended, effects in the field of estate planning.

CONCLUSION

In this Essay, I have explored two major themes. First, while the benefit-the-beneficiaries rule does have deep historical roots, it is more than simply a clarification of a single traditional rule against capricious purposes. Instead, it is a composite of multiple rules and interacts in complex ways with other principles and provisions of modern trust law. Second, when applied to a variety of potential trust provisions in the manner Professor Langbein advocates, the rule proves to be overly rigid in its practical effect. Whereas trust law historically has endeavored to balance the competing demands of settlors' intent and beneficiaries' rights, Professor Langbein's formulation of the benefit-the-beneficiaries rule is too absolutist in application. By categorizing settlor-imposed trust investment directives as either completely prudent or so capricious as to offend public policy, this rule seemingly offers no middle ground. It lacks the flexibility to differentiate wantonly destructive investment directives from more well-intentioned provisions that deviate from widespread, but not universal, theories of portfolio construction.

Professor Langbein and I see the benefit-the-beneficiaries rule through very different eyes. He emphasizes the rule's economic efficiency and its theoretical ability to maximize beneficiaries' financial interests. I see it as overbroad in practical effect, imperiling established principles of estate planning and casting a far greater shadow on trust investment law than its historical predecessors. We clearly disagree as to the virtues of this emerging rule, and we are not alone. Just shy of half of the states have now enacted the

UNIF. PRUDENT INVESTOR ACT § 3 cmt., 7B U.L.A. 29 (2006) ("[I]f a tax-sensitive trust owns an underdiversified block of low-basis securities, the tax costs of recognizing the gain may outweigh the advantages of diversifying the holding."). While this is a creative argument, the comment's references to "tax-sensitive trust" and "low-basis" suggest that the referenced exception refers to fiduciary income taxes payable out of the trust corpus.

[104] *Burn the Rembrandt?*, *supra* note 6, at 393 n.134.

[105] *Empty Promises*, *supra* note 5, at 1199-1200 (discussing GRAT investing).

UTC, while the balance have not.[106] Even some of those states adopting the broader UTC have stricken the benefit-the-beneficiaries rule from its text.[107]

My intent in this Essay has not been to resolve all controversy surrounding the benefit-the-beneficiaries rule. Rather, I have sought to explore the nature of that controversy, thereby providing judges with insight into the possible implications of an expansive application of the benefit-the-beneficiaries rule and informing the decisions of state legislators who are considering adopting or modifying the UTC or other laws governing trust investments. As courts and legislatures apply the benefit-the-beneficiaries rule to trust investment provisions, I expect that they will find that only a handful of the most extreme cases invite stark contrasts between prudence and caprice. Accordingly, courts must be flexible and balanced in their application of the benefit-the-beneficiaries rule to settlor-imposed investment directives, reflecting the reality that trust investment directives, like so many other issues of trust law, involve innumerable shades of gray.

[106] *See* NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAWS, *supra* note 2 (listing the twenty-two states and the District of Columbia, which have adopted the Uniform Trust Code). Obviously, there are many reasons why a state would choose to enact or not enact the UTC. I do not mean to suggest that a state legislature's decision to enact the UTC is a direct referendum on the wisdom of the benefit-the-beneficiaries rule.

[107] *See, e.g.*, 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); Alan Newman, *The Uniform Trust Code: An Analysis of Ohio's Version*, 34 OHIO N.U. L. REV. 135, 145 (2008) (discussing Ohio's elimination of the benefit-the-beneficiaries rule).