

## Title

Sole interest versus best interest: Equity's traditional default loyalty principle is under attack

## Summary

Some in academia have been advocating that trustees generally be held to a best-interest-of-beneficiary default standard rather than the traditional and more rigorous sole-interest-of-beneficiary default standard. See *Loring and Rounds: A Trustee's Handbook* §6.1.3 [pages 464-466 of the 2016 Edition] (the no-further-inquiry-rule). In the agent-fiduciary space, unlike the trustee-fiduciary space, those who would water down the fiduciary principle have been scoring some direct hits. See, e.g., Uniform Power of Attorney Act § 114(d): "An agent that acts with care, competence, and diligence for the best interest of the principal is not liable solely because the agent also benefits from the act or has an individual or conflicting interest in relation to the property or affairs of the principal.") The portion of §6.1.3 of the Handbook dealing with the no-further-inquiry-rule generally is reproduced in its entirety below.

## Text

The following is an enhanced excerpt from §6.1.3 of *Loring and Rounds: A Trustee's Handbook* (2016). The excerpt deals generally with the no-further-inquiry-rule primarily in the trust context.

\*\*\*\*

**The no-further-inquiry rule.** Under classic principles of trust law, the fact that the trustee engaged in an unauthorized act of self-dealing was all that the beneficiary needed to prove in an action to void the transaction. As no further proof was required, this came to be known as the "no further inquiry rule."<sup>168</sup> Whether the trustee acts in good faith<sup>169</sup> or pays a fair consideration<sup>170</sup> or erects a Chinese wall between its commercial and fiduciary departments<sup>171</sup> is immaterial.<sup>172</sup> The rule was marbled through the English common law<sup>173</sup> and is consistent with traditional civil law (continental) fiduciary principles.<sup>174</sup> It is a rule that the Restatement (Third) of Trusts for "prophylactic reasons"<sup>175</sup> has given its unqualified endorsement

---

<sup>168</sup>See *Girod v. Girod*, 45 U.S. 503, 553 (1846). See generally 3 Scott & Ascher §17.2.

<sup>169</sup>See *In re Gleeson's Will*, 124 N.E.2d 624 (Ill. App. 1955) ("The good faith and honesty of the...[trustee]...can avail...[him]...nothing so far as justification of the course he chose to take in dealing with trust proper is concerned.").

<sup>170</sup>See *In re Gleeson's Will*, 124 N.E.2d 624 (Ill. App. 1955) ("...[T]he fact that the trust sustained no loss on account of his dealings therewith...can avail...[the trustee]...nothing so far as justification of the course he chose to take in dealing with trust proper is concerned.").

<sup>171</sup>Lewin ¶20-61 (England); 3 Scott & Ascher §17.2.14.6 (noting that Chinese walls have generally proven "not very effective").

<sup>172</sup>See *Girod v. Girod*, 45 U.S. 503, 553 (1846).

<sup>173</sup>See generally Lewin ¶20-60.

<sup>174</sup>*Girod v. Girod*, 45 U.S. 503, 552-562. See generally §8.12.1 of this handbook (civil law alternatives to the trust).

<sup>175</sup>Restatement (Third) of Trusts §78 cmt. b. "In such situations, for reasons peculiar to typical trust relationships, the policy of the trust law is to prefer (as a matter of default law) to remove altogether the

and ratification.<sup>176</sup> It recognizes, however, that there are some long-standing exceptions to the rule that, for reasons of practicality, efficiency, and beneficiary interest, should be allowed to stand, *e.g.*, when the terms of the trust<sup>177</sup> or rulings of the court authorize a transaction that involves conflicting fiduciary and personal interests.<sup>178</sup> One learned commentator has articulated the rule's general policy underpinnings: In its wish to guard the highly valuable fiduciary relationships against improper administration, equity deems it better to forbid disloyalty and strike down all disloyal acts, rather than to attempt to justify...[the trustee's]...representation of two interests.<sup>179</sup>

John H. Langbein, an influential trust academic who has had minimal real-world law/trust practice experience, has been advocating for some time that trustees generally be held to a best-interest-of-beneficiary default standard rather than the traditional and more rigorous sole-interest-of-beneficiary default standard, in other words, that there be a generalized defanging of the no-further-inquiry rule.<sup>180</sup> The ivory tower, however, is not the real world, as another trust academic has reminded us:

Under the influence of law and economics theory, prominent scholars and reformers are rapidly dismantling the traditional legal and moral constraints on trustees. Trusts are becoming mere “contracts,” and trust law nothing more than “default rules.” “Efficiency” is triumphing over morality. In the law and economics universe of foresighted settlors, loyal trustees, informed beneficiaries, and sophisticated family and commercial creditors, trusting trustees may make

---

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

<sup>176</sup>Restatement (Third) of Trusts §78 cmt. b.

<sup>177</sup>*See generally* 3 Scott & Ascher §17.2.11.

<sup>178</sup>Restatement (Third) of Trusts §78 cmt. c. *See generally* §7.1.2 of this handbook (defenses to allegations that the trustee breached the duty of loyalty); 3 Scott & Ascher §§17.2, 17.2.12.

<sup>179</sup>Bogert §543; Leslie, *In Defense of the No Further Inquiry Rule: A Response to Professor John Langbein*, 47 Wm. & Mary L. Rev. 541 (2005). *But see* John H. Langbein, *Questioning the Trust Law Duty of Loyalty: Sole Interest or Best Interest?*, 114 Yale L.J. 929 (2005) (suggesting that profound historical changes over the past two centuries have rendered the no further inquiry rule obsolete).

<sup>180</sup>For the case against a defanging of the no-further-inquiry rule, *see* Melanie B. Leslie, *In Defense of the No Further Inquiry Rule: A Response to Professor Langbein*, 47 Wm. & Mary L. Rev. 541, 550–567 (2005).

sense. In the real world, however, it does not. A trust system that exalts trustee autonomy over accountability can and increasingly does impose significant human costs on all affected by trusts.<sup>181</sup>

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

**Whether charitable and noncharitable fiduciaries are held to different loyalty standards.** It has been suggested that different standards of loyalty apply to directors of charitable corporations and trustees of charitable trusts.<sup>182</sup> In the former case, it is a “best interest” standard; in the latter, it is the “sole interest” standard that we have been discussing in this section of the handbook.<sup>183</sup> It is also being put forth in some quarters that these standards are “merging,” and perhaps this is a good thing.<sup>184</sup> If it is in fact the case that the “sole interest” rule is under some kind of attack, then there really needs to be more public discussion about what such a “merger” would look like, and whether it really would be a good thing, as well as what the likely ramifications for the institution of the trust itself would be should such a merger actually be effected. With the fiduciary relationship being marginalized both in the academy<sup>185</sup> and in the marketplace,<sup>186</sup> now may not be the time to replace the no-further-inquiry rule, riddled with exceptions though it may now be, with some kind of facts-and-circumstances test. Certainly, human nature being what it is, a general facts-and-circumstances approach to divided loyalties is easier for the ignorant and the negligent and the mischief makers to game, and for their lawyers to manipulate, than is a general bright-line no-further-inquiry approach:

We have alluded to the fact that some courts have applied the “sole interest” rule mechanically,<sup>187</sup> while others have not. In one case, a trustee sold trust property to his wife and his father at fair market value. The court found the trustee's transaction with his wife voidable on public policy grounds<sup>188</sup> but not the one with his father:

In Bogert on Trusts & Trustees, Vol. 3, §484, at page 1520, the author says: “If the trustee sells to his own wife, the courts have tended to treat the transaction as subject to avoidance. The common law identity of husband and wife, the fact that a benefit to the wife would generally inure to the advantage of the husband, and the difficulty of uncovering collusion between them, all argue in favor of treating the sale to the trustee’s wife as equivalent in legal effect to a sale to himself. The

---

<sup>181</sup>Frances H. Foster, *American Trust Law in a Chinese Mirror*, 94 Minn. L. Rev. 602, 651 (2010). See also Frederick R. Franke, Jr., *Resisting the Contractarian Insurgency: The Uniform Trust Code, Fiduciary Duty, and Good Faith in Contract*, 36 ACTEC L.J. 517 (2010).

<sup>182</sup>Unif. Prudent Management Inst. Funds Act §3 cmt.

<sup>183</sup>Unif. Prudent Management Inst. Funds Act §3 cmt.

<sup>184</sup>Unif. Prudent Management Inst. Funds Act §3 cmt.

<sup>185</sup>See generally Charles E. Rounds, Jr., *The Case for a Return to Mandatory Instruction in the Fiduciary Aspects of Agency and Trusts in the American Law School, Together With a Model Fiduciary Relations Course Syllabus*, 18 Regent U. L. Rev. 251 (2005–2006).

<sup>186</sup>See generally §8.10 of this handbook (particularly the introductory quote).

<sup>187</sup>See, e.g., *In re Kline*, 142 N.J. Eq. 20, 59 A.2d 14 (1948); *Slay v. Burnett Trust*, 143 Tex. 621, 642–643, 187 S.W.2d 377, 389 (1945).

<sup>188</sup>See generally 3 Scott & Ascher §17.2.1.3 (Sale to Third Person for Trustee’s Benefit).

same doctrine should control if a woman who is trustee sells to her husband.”<sup>189</sup>

The court applied a facts-and-circumstances test in failing to void the sales to the trustee’s father:

But no legal presumption of self-dealing or bad faith arises simply because the sale of trust property was made by the trustee to his father. In this case the trustee introduced substantial evidence of the care exercised in determining the true value of the securities sold and the manner in which the sales were made. The objectors failed to produce any evidence that there was a breach of the duty by the trustee in making such sales other than that the purchaser was the father of said trustee and therefore such sale must be sustained.<sup>190</sup>

\*\*\*

---

<sup>189</sup>In re Minch’s Will, 71 N.E.2d 144, 146 (Ohio 1946).

<sup>190</sup>In re Minch’s Will, 71 N.E.2d 144, 147 (Ohio 1946).