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Rippey v. Denver United States National Bank and the Trustee's Duty of Undivided Loyalty

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RIPPEY V. DENVER UNITED STATES NATIONAL BANK AND THE TRUSTEE'S DUTY OF UNDIVIDED LOYALTY

INTRODUCTION

ON October 16, 1967, Judge William E. Doyle of the United States District Court, District of Colorado, handed down his decision in the case of *Rippey v. Denver United States National Bank*.[1] Although the case was marked by protracted legal maneuvering and heated litigation, the decision was not appealed from the trial court. Thus ended a bitterly contested legal battle over which control of *The Denver Post* hung in the balance.

The dispute arose when the Denver United States National Bank, trustee of the Agnes Reid Tammen Testamentary Trust, sold a block of shares of its *Denver Post* stock in a lot large enough to determine who would have controlling interest in the newspaper. The trustee took into consideration the interests of a third person not standing as a beneficiary of the trust — *The Denver Post* — and in so doing sold the stock to a buyer who offered less than the best possible price. The terms of the trust authorized the trustee to consider what was best for the *Post* in making a sale. Nevertheless, the court held that the trustee had clearly breached its duty of loyalty to the beneficiaries of the trust by so doing. The trustee was surcharged over two and a half million dollars for the breach.

The *Rippey* case is now precedent and, considering the judicial ability and respected position of the court, it is strong precedent at that. The ruling that the trustee breached its duty of loyalty by considering the interests of a third person, even though the trust terms authorized weighing this factor, has had a profound effect among Colorado trustees. Indeed, the implications for all fiduciaries and trustees are unsettling.

The immediate result of the *Rippey* decision has been to prompt fiduciaries to administer their trusts with more caution than before. Frequently, this will mean that trustees will seek instructions from a court prior to taking any action which might be questioned, where before they would have acted on their own initiative. Such court proceedings are in themselves costly. The long range result will surely be to make the entire activity of trust administration more

[1] 273 F. Supp. 718 (D. Colo. 1967).

conservative. This will not be a welcome result in an area of the law where overly conservative management is traditional and deeply ingrained. The pressures which already bear on trustees to make a totally safe decision deny beneficiaries the fair return on the trust capital which sound management could and should produce.[2] In fact, it may be fair to say that trust beneficiaries, as a whole, lose more financially by overly cautious management than by reasonable freedom of action in the administration of their trust.[3]

The purpose of this Note, therefore, is to examine the soundness of applying the time-honored rule of undivided loyalty to a situation in which the trust terms authorized and even required something less than one-sided loyalty to the trust beneficiaries. No dispute is made with the factual determinations and the overall result of the *Rippey* decision; nor is it the purpose of this article to address the many additional points of trust law therein considered.

In order to supplement the discussion of the undivided loyalty rule, this article will also consider some of the policies which give rise to the strictness of the rule and will examine how other courts have generally viewed the rule. Finally, this article proposes an alternative construction of the undivided loyalty rule and suggests that the solution to this perplexing problem in trust management might come by way of legislative enactment.

No one quarrels with continuing stringent legal vigilance over the fiduciary. Indeed, the very nature of the relationship demands that high standards be maintained. However, these strict rules must be carefully applied. The fiduciary in general and the trustee specifically play a prominant role in our society and the importance of that role seems to be continuously growing. With this in mind, it becomes apparent that the fiduciary must not be hampered by limitations which are too severe to allow efficient trust administration, thereby thwarting the intent of the settlor.

I. APPLICATION OF THE UNDIVIDED LOYALTY RULE

To consider the Doyle court's application of the undivided loyalty rule, the trustee's situation must be presented. The settlor empowered the trustee to sell any or all of the trust property, which consisted of controlling shares of common stock in *The Denver Post,* and provided that in exercising this power the trustee was to con-

[2] *See* the Colorado Fiduciaries' Powers Act. COLO. REV. STAT. ANN. §§ 57-8-1 to -8-8 (Supp. 1967), as an indication that the Colorado legislature recognizes this problem and has attempted to encourage more progressive and sound management, in part by allowing greater self-regulation by the trustees themselves.

[3] *See* Niles, *The Divided-Loyalty Rule,* 91 TRUSTS AND ESTATES 734, 737-38 (1952).

sider the best interests of *The Denver Post*.[4] *The Denver Post* was not a trust beneficiary. The settlor's intent appears to have been to have this stock sold in a way which would ensure continuous local control over the newspaper.[5] The settlor, no doubt, thought that local control would be in the best interest of the *Post* with resulting benefit passed along to the beneficiaries of the trust.[6]

When the trustee felt it necessary to sell most of this stock, local control was obviously one of the factors considered. As a result, the trustee found himself in a position of conflict of interest. He could sell to an outsider for a greater sum or maintain local control by selling for a lesser sum.[7] The trustee chose the latter alternative and the result was held by the court to be a breach of its duty of undivided loyalty.

The court recognized that this was not a case of self-dealing whereby the trustee obtained or was in a position to obtain benefit from an unlawful utilization of his fiduciary relationship.[8] The court did, however, after citing the general rule of a trustee's duty of loyalty,[9] state without equivocation:

> It is, of course, obvious that a fiduciary cannot allow personal motives to interfere with the discharge of its fiduciary duties. It cannot favor the interests of third persons and subordinate the interests of its beneficiaries as it did here *and this duty is not modified by the provision of Article IV of the will* which allows the trustees to enter into stockholder agreements limiting the sale of stock when such agreements would, in the sole judgment of the trustee, "promote the best interest of said company or companies [*The Denver Post*] and the beneficiaries in this Article named, and procure the best price for said stock in the event of the sale thereof."[10]

The court's pronouncement thus far seems clear; the duty of un-

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[4] The trust provision reads:

> "1. To vote said stock and exercise all rights pertaining thereto, with full control and dominion over the same, and to enter into any lawful voting trust or agreement or agreements with other stockholders of said company or companies [*The Denver Post*] . . . which in the sole judgment of the said Trustee will promote the best interest of the said company or companies and beneficiaries in this Article named, and procure the best price for said stock in the event of the sale thereof.

Rippey v. Denver United States Nat'l Bank, 273 F. Supp. 718, 724 (D. Colo. 1967). While the power of sale appears here to be discretionary, its manner is prescribed. *See* discussion note 36 *infra*.

[5] Rippey v. Denver United States Nat'l Bank, 273 F. Supp. 718, 723, 732-33 (D. Colo. 1967).

[6] This conclusion is drawn by this writer as a result of an examination of the file on the *Rippey* case lodged in the United States District Court, District of Colorado.

[7] Although the price obtained was less than that obtainable, it is arguably "reasonable" nonetheless. *See* discussion note 39 *infra*.

[8] Rippey v. Denver United States Nat'l Bank, 273 F. Supp. 718, 735 (D. Colo. 1967). "Conflict of interest" and "self-dealing" are distinguished in note 13 *infra*.

[9] Rippey v. Denver United States Nat'l Bank, 273 F. Supp. 718, 737 (D. Colo. 1967).

[10] *Id.* at 738 (emphasis added).

divided loyalty cannot be modified by a trust term granting to the trustee the power to consider the interests of third persons. But the court continues:

> While this provision allowed the trustee to consider the interests of the Post, it did not empower it to disregard the interests of its beneficiaries. In any kind of balancing of interests under this clause the beneficiaries' interests must prevail.[11]

There appears to be an internal inconsistency in this statement. On the one hand, the trustee is given power by the settlor to consider the interests of a third person. Indeed, by virtue of such a term the trustee is under a duty to do so.[12] On the other hand, the exercise of this power and the discharge of this duty will inevitably result in a breach of the trustee's duty of loyalty to his beneficiary. In other words, the *Rippey* case seems to stand for the unfamiliar proposition that the trustee's duty of loyalty to the trust beneficiary is *absolute* and cannot be modified by the terms of the trust. It is submitted that this construction departs from prior, well-established interpretations of the undivided loyalty rule.

II. CONSIDERATION OF INTERESTS OF THIRD PERSONS

There are literally hundreds of reported cases which consider the question of self-dealing and conflict of interest within the context of a trustee's duty of loyalty.[13] With few exceptions, these cases, the commentators, and the law review writers fail to consider the specific question of whether a settlor may validly provide that a trustee is to consider the interests of third persons in the administration of his trust. There is also no consideration of the trustee's duty to carry out such trust terms.[14]

A trustee's duty of loyalty arises as a result of the creation of the trust; it exists because of the fiduciary relationship.[15] The settlor need not expressly provide for it via trust terms.[16] In considering

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[11] *Id.*

[12] *See* text accompanying notes 30-33 *infra.*

[13] A distinction must immediately be drawn between "self-dealing," whereby a trustee profits or gains something by way of his fiduciary relationship or stands to do so, as would be the case in a sale of his own property to the trust, and "conflict of interest," whereby the trustee finds himself to be in the position of consideration of interests other than the beneficiary's. Conflict of interest is the broader term encompassing self-dealing. The latter is the subject of greater judicial condemnation. Fletcher, *Divided Loyalty and Self-Dealing,* 94 TRUSTS AND ESTATES 234 (1955); Niles, *The Divided-Loyalty Rule,* 91 TRUSTS AND ESTATES 734 (1952).

[14] The authorities considered in notes 15-22 *infra,* illustrate how courts and authors alike cite basic trust rules without drawing them together to properly conclude that a settlor may include a term in the trust instrument allowing the trustee to consider the interests of third parties without breaching his duty of undivided loyalty, the settlor thereby modifying the trustee's duty of loyalty.

[15] 2 A. SCOTT, TRUSTS § 170, at 1193 (2d ed. 1956); RESTATEMENT (SECOND) OF TRUSTS § 170 (1959).

[16] 2 A. SCOTT, *supra* note 15.

any alleged breach of this duty, courts uniformly proclaim what writers on the subject also proclaim — the most fundamental duty that a trustee owes to his beneficiary is the duty of undivided loyalty.[17] The nature of the fiduciary relationship demands the duty of loyalty because (1) the relationship lends itself to secret exploitation of the trust res by the trustee; (2) human nature indicates that where a conflict of interest exists the trustee may well favor his own interest in a situation of self-dealing, or his judgment may be biased adversely to the beneficiary's interest; and (3) the chance of discovering such conflict is remote.[18] Thus, the courts have adopted an extremely strict attitude towards the trustee when any conflict of interest is found.[19] This attitude is clearly illustrated by Mr. Justice Cardozo's now famous statement in the case of *Meinhard v. Salmon*:

> 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. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the "disintegrating erosion" of particular exceptions. . . . Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd.[20]

Such an "unbending and inveterate" tradition of "uncompromising rigidity" often prevents further inquiry into any given case. As soon as any conflict of interest comes to the attention of the courts, they generally refuse to hear any excuses or defenses,[21] and the trustee is held liable for any loss to the trust estate regardless of whether there is any direct causal relation between the breach and the loss.

The duty of loyalty as generally viewed by the courts and commentators is stated in the following manner: a trustee must adminis-

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[17] Vest v. Bialson, 365 Mo. 1103, 293 S.W.2d 369 (1956); *In re* Hammer's Estate, 23 MISC. 2d 362, 198 N.Y.S.2d 689 (Sur. Ct. 1960), *rev'd on other grounds*, 16 App. Div. 2d 111, 225 N.Y.S.2d 868 (1962); 3 G. BOGERT, TRUSTS § 543 (1960); RESTATEMENT (SECOND) OF TRUSTS § 170 (1959); 2 A. SCOTT, *supra* note 15; Hoover, *Basic Principles Underlying Duty of Loyalty*, 5 CLEV.-MAR. L. REV. 7 (1956); Scott, *The Fiduciary Principle*, 37 CALIF. L. REV. 539 (1949); Scott, *The Trustee's Duty of Loyalty*, 49 HARV. L. REV. 521 (1935-36).

[18] Hoover, *supra* note 17, at 10.

[19] *Id.* at 14.

[20] 249 N.Y. 458, 464, 164 N.E. 545, 546 (1928).

[21] For example, Hoover, *supra* note 17, lists over fifteen defenses, such as "good faith" and "action benefiting the trust" which are summarily discarded once a conflict of interest is shown. Another example is the "no further inquiry rule" of New York, essentially synonymous with the point made by Mr. Hoover, except with this latter rule, if a conflict of interest only as opposed to self-dealing is shown, the court *may* consider other circumstances such as good faith. Niles, *supra* note 13.

ter his trust solely in the interest of the beneficiary; he must exclude all self-interest, *as well as all consideration of the welfare of third persons*; he is prohibited from *placing himself* in a position in which interests of his own *or of others* conflict or may possibly conflict with the interest of the trust; he must at all times render a disinterested judgment in trust affairs.[22]

Nowhere in this statement of the rule or in the cases is it stated that the settlor is prohibited from modifying this duty of loyalty.[23] Quite to the contrary, the commentators and cases agree that the settlor by the terms[24] of his trust instrument may permit the trustee to do what, in the absence of such a provision or a provision that is illegal or contrary to public policy,[25] would be a violation of the

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[22] Phelan v. Middle States Oil Corp., 220 F.2d 593 (2d Cir. 1955); Brown v. McLanahan, 148 F.2d 703 (4th Cir. 1945); Cleveland Clinic Foundation v. Humphrys, 97 F.2d 849 (6th Cir. 1938); Hardy v. Hardy, 217 Ark. 333, 230 S.W.2d 6 (1950); Vokal's Estate, 121 Cal. App. 2d 25, 263 P.2d 64 (1953); Zottarelli v. Pacific States Sav. & Loan Co., 94 Cal. App. 2d 480, 211 P.2d 23 (1949); Glengary Consol. Mining Co. v. Boehmer, 28 Colo. 1, 62 P. 832 (1900); Conway v. Emeny, 139 Conn. 612, 96 A.2d 221 (1953); Stiner v. Hawaiian Trust Co., 47 Hawaii 548, 393 P.2d 96 (1964); Anderson v. Bean, 272 Mass. 432, 172 N.E. 647 (1930); Detroit Trust Co. v. Mason, 309 Mich. 281, 15 N.W.2d 475 (1944); Morrison v. Asher, 361 S.W.2d 844 (Mo. 1962); City Bank Farmers Trust Co. v. Cannon, 291 N.Y. 125, 51 N.E.2d 674 (1943); *In re* Hammer's Estate, 23 Misc. 2d 362, 198 N.Y.S.2d 689 (1960); Dombey v. Rindsfoos, 105 Ohio App. 335, 151 N.E.2d 563 (1958); Muth v. Maxton, 68 Ohio L. Abs. 164, 119 N.E.2d 162 (1954); Bolton v. Stillwagon, 410 Pa. 618, 190 A.2d 105 (1963); *In re* Noonan's Estate, 163 Pa. Super. 70, 60 A.2d 374 (1948); 3 G. BOGERT, *supra* note 17; RESTATEMENT (SECOND) OF TRUSTS § 170 (1959); 2 A. SCOTT, *supra* note 15; Hoover, *supra* note 17; Scott, *The Fiduciary Principle, supra* note 17; Scott, *The Trustee's Duty of Loyalty, supra* note 17.

[23] Some courts have taken a position closely aligned with that of the *Rippey* court. Their reasoning is that while a lawful power may be granted to a trustee, he cannot exercise it in a way that is detrimental to the beneficiary. For example, in Brown v. McLanahan, 148 F.2d 703, 709 (4th Cir. 1945), the court stated, "The . . . breach of trust of one who occupies a fiduciary relation while in the exercise of a lawful power is as fatal in equity to the resultant act or contract as the absence of the power." *See also Report of Subcommittee on the Outer Limits of Trustee Powers,* 101 TRUSTS AND ESTATES 953, 954 (1962).

[24] Since the extent and nature of a trustee's powers and duties are determined by the "terms of the trust," it would be well to define what is meant by the phrase. The terms of the trust are the "manifestation of the intention of the settlor with respect to the trust, expressed in a manner which admits of its proof in judicial proceedings, whether expressed by written or spoken words or by other conduct." 2 A. SCOTT, *supra* note 15, at § 164.1.

[25] Wolfer v. National City Bank, 189 Misc. 711, 68 N.Y.S.2d 212 (Sup. Ct. 1947), held that it is not contrary to public policy to allow the settlor to provide that a trustee may consider interests in conflict with the interests of the beneficiary, nor is it contrary to public policy to give effect to such a provision in his trust administration. Morris v. The Broadview, Inc., 328 Ill. App. 267, 65 N.E.2d 605, 608 (1946), held that it is in the public interest not to impair the freedom of contract unless clearly contrary to public policy or law; a trust provision granting a trustee the power to deal with trust certificates for the trust and to own them for his own account is not contrary to public policy. The court stated, "[A]nyone competent to contract may make such disposition of the legal title to his property as he pleases, may annex such conditions and limitations to its enjoyment as he chooses, and may vest it in trustees for the purpose of carrying out his intention." *See* also 2 A. SCOTT, *supra* note 15, § 164; *Report of Subcommittee, supra* note 23; *cf.* Crutcher v. Joyce, 134 F.2d 809 (10th Cir. 1943).

trustee's duty of loyalty.[26] Thus, the cases hold that a settlor may allow a trustee to self-deal.[27] Indeed, some cases have gone so far as to find an *implied* trust term allowing self-dealing.[28] As noted,[29] self-dealing is condemned to a greater degree than conflict of interest, and a settlor's term allowing consideration of a third party's interest creates a situation of the less rigid conflict of interest, not of self-dealing.

A trust provision allowing limited self-dealing constitutes only one aspect of the broader principle that the nature and extent of the trustee's powers and duties[30] are determined by the terms of the trust;[31] and further, that the trustee is under a *duty*[32] to carry out the terms of the trust and thereby manifest the intention and purpose of the settlor, limited, of course, by illegality and public policy.[33]

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[26] Rosencrans v. Fry, 12 N.J. 88, 95 A.2d 905 (1953); *In re* Durston's Will, 297 N.Y. 64, 74 N.E.2d 310 (1947); Appeal of Burke, 378 Pa. 616, 108 A.2d 58 (1954); Dallas Dome Wyoming Oil Fields Co. v. Brooder, 55 Wyo. 109, 97 P.2d 311 (1939); RESTATEMENT (SECOND) OF TRUSTS § 170, comment *s* at 372 (1959); 2 A. SCOTT, *supra* note 15, §§ 164, 170.9; Niles, *supra* note 13, at 736; *Report of Subcommittee, supra* note 23; Scott, *The Trustee's Duty of Loyalty, supra* note 17.

[27] Morris v. The Broadview, Inc., 328 Ill. App. 267, 65 N.E.2d 605 (1946); Boston Safe Deposit & Trust Co. v. Lewis, 317 Mass. 137, 57 N.E.2d 638 (1944); Appeal of Burke, 378 Pa. 616, 108 A.2d 58 (1954); RESTATEMENT (SECOND) OF TRUSTS § 170, comment *t* at 372 (1959).

[28] *In re* Flagg's Estate, 365 Pa. 82, 73 A.2d 411 (1950). The court held that the testator *impliedly* contemplated self-dealing, thus modifying an otherwise absolute duty. The court thought it unimportant that authority to engage in self-dealing was implied rather than explicit. *Accord,* Boston Safe Deposit & Trust Co. v. Lewis, 317 Mass. 137, 57 N.E.2d 638 (1944).

[29] *See* discussion note 13, *supra.*

[30] A settlor may grant to a trustee the "power" to self-deal or to consider third party interests. In so doing he modifies the trustee's "duty" of undivided loyalty towards the beneficiary. Because the "duty" of loyalty is thus modified, an exercise by the trustee of the above power (reasonably and in good faith, of course) cannot be a breach of trust.

[31] *In re* Schuster's Estate, 35 Ariz. 475, 281 P. 38 (1929); *In re* Hartzell's Will, 43 Ill. App. 2d 118, 192 N.E.2d 697 (1963); Oak Investment Corp. v. Martin, 107 N.J. Eq. 123, 151 A. 874 (1930); 2 A. SCOTT, *supra* note 15, § 164.1.

[32] Conway v. Emeny, 139 Conn. 612, 96 A.2d 221, 225 (1953). The court stated: "It was the *duty* of the trustees to conform strictly to the directions which the testatrix gave. . . . *[The] obligation to obey the instructions of the donor of the trust is the cornerstone upon which all other duties rest.*" (emphasis added). In *In re* Hughes' Will, 241 Wis. 257, 5 N.W.2d 791 (1942), it was pointed out that the trustee represents both the settlor and the cestui and owes a "duty" to administer the trust in accordance with the trust terms.

[33] When the terms of a trust instrument are clear and unmistakable and capable of being carried out, there is no doubt that it is the trustee's duty to follow such explicit directions, which constitute the written expression of the trustor's intent. Reedy v. Johnson's Estate, 200 Miss. 18, 26 So.2d 685 (1946); *accord,* Tait v. Anderson Banking Co., 171 F. Supp. 3 (S.D. Ind. 1959); *In re* Ferrall's Estate, 41 Cal. 2d 166, 258 P.2d 1009 (1953); Walker v. Doak, 210 Cal. 30, 290 P. 290 (1930); Union Bank & Trust Co. v. McColgan, 84 Cal. App. 2d 208, 190 P.2d 42 (1948); Robison v. Elston Bank & Trust Co., 113 Ind. App. 633, 48 N.E.2d 181 (1943); *In re* Marble, 136 Me. 52, 1 A.2d 355 (1938); McDaniel v. Hughes, 206 Md. 206, 111 A.2d 204 (1955); Hughes v. McDaniel, 202 Md. 626, 98 A.2d 1 (1953); Sword v. Marquette Nat'l Bank, 252 Minn. 544, 91 N.W.2d 75 (1958); St. Louis Union Trust Co. v. Ghio, 240 Mo. App. 1033, 222 S.W.2d 556 (1949); *In re* Cook's Will, 136 N.J. Eq. 123, 40 A.2d 805 (1945); *In re* Buckelew's Estate, 128 N.J. Eq. 81, 13 A.2d 855 (1940).

It may be argued that if the trust provision is made discretionary as opposed to mandatory[34] the trustee is not under a duty to exercise this discretion. Rather, if such an exercise of discretion would be contrary to the rule of undivided loyalty, he is under a duty not to exercise that discretion.

The statements of the rule, however, are not so limited.[35] For example, if the trustee is given discretion to sell trust property as in the *Rippey* case, he must exercise that discretion in the manner prescribed by the terms of the trust in order to completely manifest the intention and purposes of the settlor.[36] He must act in that state of mind in which the settlor contemplated he would act.[37]

Thus, the trustee has two primary duties: (1) the duty to carry out the terms of the trust and (2) the duty of loyalty. The trustee is in effect a middleman. He represents *both* the settlor and the beneficiary.[38] Because the nature and extent of the trustee's powers

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[34] *See* 3 G. BOGERT, *supra* note 17, at § 552. In stating the rule that the trustee must carry out the directions of the settlor exactly, in order to manifest his intent and purpose, at least one court qualified the rule by saying in effect, in the *absence of discretion* the trustee must comply strictly with the trust terms. Bryson v. Bryson, 62 Cal. App. 170, 216 P. 391 (1923).

[35] Carter v. Rolland, 11 Humph. 333, 338 (Tenn. 1850), stated, "The powers, duties and responsibilities of trustees necessarily vary with the directions, limitations and restrictions contained in the instrument under which they assume to act; their general duty is, to do whatever may be necessary and proper, to give effect to the purposes contemplated by the trust; the intention of the instrument is to guide their action and to protect them in the performance of their duty." It is stated in 4 J. POMEROY, EQUITY JURISPRUDENCE § 1062 (5th ed. 1941): "The trust itself, whatever it be, constitutes the charter of the trustee's powers and duties; from it he derives the rule of his conduct; it prescribes the extent and limits of his authority; it furnishes the measure of his obligations. If the trust is express, created by deed or by will, then the provisions of the instrument must be followed and obeyed." [Footnote omitted.]

[36] Nashville Trust Co. v. Lebeck, 197 Tenn. 164, 270 S.W.2d 470, 475 (1954) (where the settlor of a trust directs the trustee to dispose of property by sale in a certain prescribed manner and that direction violates no positive rule of law, the trustee must carry out the settlor's intention); *accord,* Crutcher v. Joyce, 134 F.2d 809, 816 (10th Cir. 1943), stating, "The provisions of a trust fixing the *mode,* the time, and the *conditions* for the execution of the powers are exclusive of others, if not forbidden by law or public policy." [Emphasis added.] In Welch v. Mann's Ex'r, 261 Ky. 470, 88 S.W.2d 1, 3 (1935), the court stated: "When the mode of executing a power is definitely prescribed by the creator, the trustee or donee is without authority to employ a different method, and any attempt to do so is void." *See* Loftin v. Kenan, 155 Misc. 552, 280 N.Y.S. 28 (Sup. Ct. 1935) (trust for 21 years for the purpose of "keeping together" a railroad was given effect); Berry v. McCourt, 1 Ohio App. 2d 172, 204 N.E.2d 235 (1965) (settlor's intention to keep a business in the family and under family control for as long as possible must be effectuated). *But see In re* Pulitzer's Estate, 139 Misc. 575, 249 N.Y.S. 87 (Sur. Ct. 1931), wherein a trust term stating settlor's intention to preserve a newspaper, forbidding a sale thereof, was subordinated to the presumed intention to benefit the cestuis que trustent. Extreme circumstances were deemed to necessitate this intervention of equitable judicial power. Note, however, the caveat to the exercise of this equitable power in Russell v. Russell, 109 Conn. 187, 145 A. 648, 652 (1929), where the court stated: "[I]t should be most carefully and sparingly used, and it is to be borne in mind that it is the necessity of the situation which brings it into operation, *not the mere fact that thereby the estate may be administered in a way which will be more advantageous to its beneficiaries.*" [Emphasis added.]

[37] *In re* Ferrall's Estate, 41 Cal. 2d 166, 258 P.2d 1009 (1953); Read v. Ringsby, 156 Neb. 33, 54 N.W.2d 318 (1952); 2 A. SCOTT, *supra* note 15, § 187.

[38] *In re* Hughes Will, 241 Wis. 257, 5 N.W.2d 791 (1942).

and duties are defined by the trust terms, because by these terms the settlor can modify the trustee's duty of loyalty, and because the trustee is under a duty to carry out the terms of the trust in the prescribed manner, it is this writer's conclusion that the settlor may by a trust term validly empower the trustee to consider the interests of third persons. The duty of undivided loyalty, which the trustee otherwise owes to the beneficiary, can therefore be modified. Any reasonable[39] action taken by the trustee whereby the interests of third persons are considered in dealing with trust property should not be deemed a breach of trust.

The foregoing principles are squarely set out in the case of *Wolfer v. National City Bank.*[40] This case is one of the few to clearly and logically consider the issue; consequently, it is quoted at length in the body of this text. The court stated:

> The standard of loyalty for fiduciary relations does not permit a trustee to create or to occupy a position in which he has interests to serve other than the interest of the trust estate. Undivided loyalty is the supreme test. Meinhard v. Salmon, 249 N.Y. 458, 464, 164 N.E. 545, 546, 62 A.L.R. 1. Plaintiffs urge that the defendant by permitting its securities affiliate, the Company, to participate in the selection of securities to be included in the trust, placed itself in a position of divided loyalty as a matter of law. . . .
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> . . . .
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> It is well settled in this state, however, that a settlor of a trust has the right to select the agencies by which his bounty is to be distributed and to impose the terms and conditions under which it is done. Denike v. Harris, 84 N.Y. 89, 94; Crabb v. Young, 92 N.Y. 56, 65; Matter of Balfe, 245 App. Div. 22, 280 N.Y.S. 128, 130, 131. In the Balfe case, the Court, holding that there was no basis for the surcharge of the corporate trustee, said, "the descedent was willing that the trustee should act under conditions of divided loyalty. He had the power and right to so provide. That which he knowingly did with his own property did not impinge public policy or involve the doing of anything malum in se or malum prohibitum."
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> To the same effect are the rules of law expounded in the Restatement of the Law of Trusts. Thus, Section 170, subdivision s:
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> "Terms of the Trust. By the terms of the trust the trustee may be permitted to sell trust property to himself individually, or as trustee to purchase property from himself individually, or to lend to himself money held by him in trust, or otherwise to deal with the trust property on his own account. The trustee violates his duty to the beneficiary, however, if he acts in bad faith no matter

[39] Braman v. Central Hanover Bank & Trust Co., 138 N.J. Eq. 165, 47 A.2d 10, 24 (1946), states that the trustee has a duty of loyalty to his beneficiary, "but that duty does not justify him in acting against his own judgment, for the responsibility is the trustee's and not the beneficiary's. 2 Scott on Trusts 856, sec. 170. 'As long as he (a trustee) is not acting in his own interest the standard fixed for his behavior is only that of a reasonable degree of care and skill and caution.' 2 Scott on Trusts, 909, sec. 170.25."

[40] 189 Misc. 711, 68 N.Y.S.2d 212 (Sup. Ct. 1947).

> how broad may be the provisions of the terms of the trust in conferring power upon him to deal with the trust property on his own account."
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> Though "uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty" (Meinhard v. Salmon, supra) . . . this Court is powerless to act where the trust agreement itself permits the "disintegrating erosion" of particular exceptions.[41]

Finally, if the duty of loyalty can be modified, other duties of the trustee owed to the beneficiary might be consequentially modified, *e.g.,* the duty to obtain the best price possible in a sale of trust property.[42]

III. POLICY CONSIDERATIONS

The basic policy question of the propriety of trust terms providing for the consideration of the interests of third persons in the administration of a trust has seldom received comment. At this point, it might be well to consider what are those policies as viewed from the perspective of the settlor, the trustee, the beneficiary, the third person, the courts, and the legislature.

First, consider the point of view of the beneficiary. Because of the nature of the trust relationship, he is dependent upon the trustee to administer the trust for his benefit. Naturally, he wants the maximum benefit possible. Because of the nature of his relationship to the trustee, he is often in need of court imposition of strict rules of fiduciary law. Further, because of his position of disadvantage, the courts have been most strict with trustees to insure protection of the beneficiary's interest. But the beneficiary must remember that he owes his position of gain to the settlor's dispositive motive.

Consider the settlor's point of view. He is making a disposition. By trust law, he has the right to control the entire disposition of the property and its subsequent administration His intent and purpose is paramount — thus, the trust agreement.

Now consider the trustee. By accepting the trust he undertakes the duty of manifesting the purpose and intent of the settlor. He is also under a duty to administer the trust in the best interest of his beneficiary; but, the extent of this duty is dependent upon the trust terms, and this duty of loyalty may be modified by the settlor's

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[41] 68 N.Y.S.2d at 215-16.

[42] For an excellent discussion of this duty, albeit with reference to English law, see Bodkin, *Duty of Trustees for Sale to Obtain the Best Price,* 14 CONVEYANCER AND PROPERTY LAWYER 228 (1950).

express provisions in the trust. The beneficiary can only expect the trustee to follow the terms of the trust and manifest the settlor's intent and purpose. If as a result of so doing, a third party's interest is considered, the beneficiary should not be heard to complain, and the trustee should be protected by the trust terms.[43]

What of the third party? He is not a trust beneficiary and thus cannot invoke the aid of a court if the trustee disregards the instructions of the settlor by failing to consider his interests. While it is outside the scope of this Note to do more than raise the issue, *he* may have some possibility for relief under third-party-beneficiary-contract theory.

Much has been said already of the "unbending and inveterate" tradition of "uncompromising rigidity" of the courts.[44] Some courts might insist that the trustee, who discovers that the settlor has placed him in a position of conflict of interest, petition for instruction. The trustee will protect himself by such a petition,[45] but an instruction which takes the position of the *Rippey* court would result only in a frustration of the settlor's intent.[46] A court cannot allow deviation from the settlor's expressed intent absent emergency circumstances.[47] Nor should such action on the part of the trustee be necessary where the trust provision is clear.[48]

Heretofore, the draftsman of a trust instrument has faced increasing challenge in his attempt to transfer extremely broad powers to the trustee. The outer limits of permissible grants of power have been defined by public policy considerations and by rules of common law, both of which have previously been discussed. In addition, those limits are defined by statute.[49] Certainly, statutes also reflect public policy. What then is the point of view of the legislature?

The Colorado legislature, by enacting the Colorado Fiduciaries' Powers Act,[50] has taken a step in the right direction. The adoption

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[43] Dabney v. Chase Nat'l Bank, 196 F.2d 668, 675 (2d Cir. 1952), states, "The law ought not make trusteeship so hazardous that responsible individuals and corporations will shy away from it." *See* Niles, *supra* note 13. Mr. Niles pleads for a more realistic judicial view of the trustee's plight. He feels that the overly inflexible rule of undivided loyalty has in the long run worked to the detriment of the beneficiary and that legislative reform is needed. *Cf.* Carter v. Rolland, 11 Humph. 333, 338 (Tenn. 1850).

[44] *See* text accompanying notes 20, 21 *supra.*

[45] RESTATEMENT (SECOND) OF TRUSTS § 201 (1959).

[46] Not only is the settlor's intention thwarted where the law states that it need not be, but bad precedent is or may be established.

[47] *In re* Pulitzer's Estate, 139 Misc. 575, 249 N.Y.S. 87 (Sur. Ct. 1931).

[48] Fratcher, *Trustees' Powers Legislation,* 37 N.Y.U.L. REV. 627 (1962).

[49] *See Report of Subcommittee, supra* note 23; Niles, *supra* note 13. Both sources are in agreement that a skilled and clever draftsman can provide for modified duty of loyalty and consideration of third party interests.

[50] COLO. REV. STAT. ANN. §§ 57-8-1 to -8-8 (Supp. 1967).

of the Act reflects a realistic, contemporary approach.[51] An underlying purpose of the Act is to alleviate the problem of undue common law restrictions on the trustee's actions. The Act confers many specific powers upon the trustee, including powers which have been interpreted to be self-dealing under the common law.[52] It broadly empowers the fiduciary to do every act reasonably necessary to administer the trust without the necessity of court administration or the need for such authorization in the trust instrument.[53] Unless the trust terms restrict these grants of power,[54] they exist by virtue of the statute in every Colorado trust. At the same time, the statute imposes upon the fiduciary the duty to act reasonably and equitably with due regard for his obligation and responsibility toward the interest of the beneficiaries, the estate or trust, and its purposes.[55] Thus, the Act provides for increased flexibility, ease of trust administration, and trustee self-regulation.

Prior to the passage of this Act, the trustee's discretionary decisions concerning the administration of the trust were made at his peril. The Colorado statute should relieve the trustee from these sometimes ancient and now outdated restrictions of the common law.

It is not suggested, however, that, had the Act been applicable to the *Rippey* case, a different decision would have been reached. It is suggested that, had the court applied the principles

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[51] 24 COUNCIL OF STATE GOVERNMENTS, SUGGESTED STATE LEGISLATION 191 (1965), states:

> Increased flexibility in the exercise of investment powers attendant upon the enactment of "prudent man" rule investment statutes has suggested the advisability of extending the same principle to the field of trustees' powers generally. Greater reliance is thereby placed upon trustee self-regulation rather than upon trustor restriction to protect the fulfillment of trust puposes without depriving a trustor of power to impose trust power restrictions if he wishes so to do.
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> The proposed Uniform Trustees' Powers Act accepts the premise that in the trusts to which the act applies (§§ 1, 8) the trustees' powers should be commensurate with the duties of the trustee acting as a prudent man (§ 1(3)) to perform the purposes of the trust in the absence of trust restrictions on such powers (§§ 1, 2). Accordingly: first, "the trustee has the power to perform, without court authority, every act which a prudent man would perform for the purposes of the trust including but not limited to powers specified in" Section 3 (c); and whether or not otherwise existing restrictions on the scope of powers conferred would exist but for the act; second, the trustee is not absolved from "his obligation as a fiduciary" except in the case of certain so-called self-dealing powers (§ 3 (c) (1), (4), (6), (18), (25), § 3 (b)) the exercise of which nevertheless continues subject to prudent man requirements; and third, with respect to the exercise of trust powers, third persons dealing with the trustee are protected (§ 7). Other provisions are included relating to trustees' powers.
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> For a basic review of the underlying theory of the Uniform Trustees' Powers Act as drafted, see Professor William F. Fratcher's article entitled "Trustees' Powers Legislation" published in *New York University Law Review*, June, 1962, Vol. 37, No. 4, pp. 625[*sic*]-664.

[52] COLO. REV. STAT. ANN. §§ 57-8-4 (1), (2), (n), (q), (r) (Supp. 1967).

[53] *Id.* § 57-8-4 (1).

[54] *Id.* § 57-8-3.

[55] *Id.* § 57-8-4 (1).

behind the Act and had the court viewed the common law rules as analyzed in this article, effect would have been given to the trust provision allowing the trustee to consider the interest of a third party.

Finally, although the Colorado Fiduciaries' Powers Act increases the efficiency of trust administration by relieving the trustee of many restrictions, further legislation may be desirable. England has gone further in one respect. Should a breach of trust be found, the English Act may be applicable to relieve the trustee of liability if he has acted in good faith and ought fairly to be excused.[56] This presents an advanced policy position from the one taken by American courts which refuse to hear any excuses or defenses when they determine that the trustee is in an unauthorized position of conflict of interest.[57]

The English Act and its function within the context of trustee sales has been analyzed by Mr. E. H. Bodkin, an English barrister, who stated:

> The court has always recognized the difficulties in which trustees may be placed in the conduct of the negotiations [for sale] through no fault of their own. The ommission of the trustees to obtain the directions of the Court was always a material consideration . . . . But it may be impossible to obtain such directions where there are rival offers. The modern practice of signing an agreement subject to contract may also be thought to have further loaded the scales against trustees, as it has increased the period during which they may consider themselves morally bound to a purchaser. Trustees may now be relieved under section 61 of the Trustee Act, 1925, if they have acted honestly and reasonably and ought fairly to be excused for the breach of trust and for omitting to obtain the directions of the Court. . . . Further it appears to follow . . . that the fact that the trustees acted contrary to the express wishes of a beneficiary would not prevent the Court from considering that they ought "fairly to be excused."[58]

The specific language of section 61 of The Trustee Act, 1925, is as follows:

> 61. Power to relieve trustee from personal liability. — If it appears to the court that a trustee, whether appointed by the court or otherwise, is or may be personally liable for any breach of trust, whether the transaction alleged to be a breach of trust occurred before or after the commencement of this Act, but has acted honestly and reasonably, and ought fairly to be excused for the breach of trust and for omitting to obtain the direction of the court in the matter in which he committed such breach, then the court may relieve him either wholly or partly from personal liability for the same.[59]

The preliminary note to this statute instructs that the language of

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[56] The Trustee Act, 1925, 15 Geo. 5, c. 19, § 61.

[57] *See* text and authorities cited note 21 *supra.*

[58] Bodkin, *supra* note 42, at 233-34.

[59] The Trustee Act, 1925, 15 Geo. 5, c. 19, § 61.

section 61 is wide and that narrow constructions should be avoided. Its purpose was to give to the court the power to relieve an honest trustee in proper cases.[60]

CONCLUSION

The present state of the common law already supports a conclusion that a trustee can consider the interest of a third person without breaching his duty of loyalty to the trust beneficiary, provided that the trust authorized him to do so. However, the court which decided the *Rippey* case held that such consideration was a breach of trust. Colorado's new Fiduciaries' Powers Act expresses a legislative intent that trustees be relieved of some of the more conservative trust rules which have traditionally hampered sound trust management. However, with the *Rippey* case now reported, new legislation which specifically overrules the holding in *Rippey* — since the Act does so only inferentially — will probably be necessary to change its unwelcome force and effect. Until legislation is enacted, trust administration in all its facets will be unsettled, and the beneficiaries will suffer as a result. The settlor's intent and purpose may well be thwarted, and the very purpose for the undivided loyalty rule is wholly or partially defeated. This need not be so.

Lewis T. Babcock

[60] 26 HALSBURY'S STATUTES OF ENGLAND 7-8 (2d ed. 1951).