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Removal of Corporate Trustees Under the Uniform Trust Code and Other Current Law: Does a Contractual Lense Help Clarify the Rights of Beneficiaries?

Ronald Chester*
Sarah Reid Ziomek**

“Not one . . . is altogether noble, nor altogether trustworthy,
nor altogether consistent; and not one is altogether vile”¹

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1. H.G. WELLS, *THE OUTLINE OF HISTORY* ch. 40 (1920), *reprinted in* JOHN BARTLETT, *FAMILIAR QUOTATIONS* 720 (Emily Morrison Beck et al. eds., 15th ed. 1980).

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I. INTRODUCTION: VIEWING TRUSTEE REMOVAL THROUGH A CONTRACTUAL LENSE

Over the last decade, the inability of trust beneficiaries to remove corporate trustees, absent a breach of trust or express language in the trust, has been making news.² Take the example of a sixty-eight-year-old widow whose income from her late husband's trust was her means of support. A bank had been named as trustee of the trust. When the trust income was insufficient to pay for major dental work, the widow asked the bank for \$20,000 out of the trust principal to help cover the costs. The bank told her to have her teeth pulled instead. When she sued to have the bank removed as trustee, she discovered that the bank had the legal right to use the trust funds to defend itself.³

The reluctance of the American legal system to allow trust beneficiaries to change corporate trustees has been the particular bugaboo of the HEIRS® organization, a vocal advocacy group of trust beneficiaries led by Standish Smith.⁴ The principal reason for this reluctance lies in the tenet announced in *Clafin v. Clafin*⁵ preventing trust termination (or, by implication, modification) where such changes contravene a material purpose of the settlor. Because changing trustees (or "portability" as HEIRS® calls it) can be seen as a type of trust modification, courts have been hesitant to permit it. As *Clafin* indicates,

2. Recently, in March 2001, a small group of protesters gathered outside the Deutsche Bank building in Manhattan, New York. They accused the bank of mismanaging trust accounts, including a \$17-million estate. See *Good Rats*, MANHATTAN STYLE: CITY LIFE AT ITS BEST, Mar./Apr. 2001, at 68. For further commentary, including additional episodes, see also Donald Jay Korn, *Revolt of the Trust-Fund Babies*, FIN. PLAN., Feb. 1996, at 41, and Kathy Kristof, *An Heir of Confidence*, CHI. TRIB., May 21, 1996, at C7.

3. See Lewis Beale, *An Heir-Raising Enterprise*, L.A. TIMES, Nov. 18, 1992, at E1 (also containing other "horror-stories"). The chilling effect of the ability of corporate trustees to use trust funds to defend against a removal action is a very real issue, but is beyond the scope of this Article. The question of the award of fees and costs arises in the realm of remedies and is not truly susceptible to the contractual (or trust) analysis used herein. See also *infra* notes 35, 137, and accompanying text.

4. HEIRS®, an organization of beneficiaries for trust reform, is a non-profit corporation located in Villanova, Pennsylvania. For a number of years, Standish Smith has dealt with the practical problems posed by irrevocable personal trusts and is personally committed to improving the administration of the family trust.

5. 20 N.E. 454 (Mass. 1889).

American trust law traditionally has protected settlor intent more zealously than the interests of the beneficiaries.⁶

English trust law, by contrast, appears to care little about settlor intent when the question is modification or termination, announcing quite firmly that the beneficiaries' interests are paramount.⁷ However, trustee removal and/or change sufficiently troubles the English that their courts often force the beneficiaries to terminate the existing trust and establish a new one with a new trustee.⁸ Because the *Clafin* doctrine often blocks trust termination in the United States, American beneficiaries generally do not have this option.⁹

Recent reforms in American trust law appear to be responding to beneficiaries regarding their difficulties in removing an unsatisfactory corporate trustee.¹⁰ For example, under Section 706 of the Uniform Trust Code ("UTC"),

6. See, e.g., *West v. Third Nat'l Bank*, 417 N.E.2d 991, 993 (Mass. App. Ct. 1981) (holding that a beneficiary of a life estate in a testamentary trust could not compel its termination where the testator's intent to provide support for the beneficiary throughout her life had not been achieved); *In re Estate of Brown*, 528 A.2d 752, 755 (Vt. 1987) (holding that termination of the trust by the beneficiaries would not be allowed because termination would defeat the settlor's intention); GEORGE G. BOGERT & GEORGE T. BOGERT, *TRUSTS AND TRUSTEES* §§ 1007-1008 (2d ed. rev. 1983) (discussing additional cases).

7. See 48 HALSBURY'S LAWS OF ENGLAND para. 645 (4th ed. 2000). See generally *Stephenson v. Barclays Bank Trust Co. Ltd.*, 1 W.L.R. 882, 889 (1975); *Don King, Inc. v. Warren*, 3 W.L.R. 276, 303-04 (1999), *aff'd*, 3 W.L.R. 276 (C.A. 1999).

8. See *Re Brockbank*, *Ward v. Bates*, 1 All E.R. 287 (1948) (the leading case, holding that beneficiaries may remove a trustee by terminating the trust and creating a new trust). Short of establishing a new trust, English courts often balk at trustee change at the demand of the beneficiaries. See E-mail from David Hayton, Professor, School of Law, King's College, London, to Ronald Chester, Professor of Law, New England School of Law (June 22, 2001) [hereinafter E-mail from David Hayton] (on file with Authors). Since contrary settlor intent cannot be the reason in England, it appears that desire for smooth trust administration or perhaps concern for the office of trustee itself can cause the English courts to turn a deaf ear to beneficiary complaints about their trustee.

9. See *Clafin*, 20 N.E. at 456.

10. For instance, the drafters of the *Restatement (Third) of Trusts* have introduced in Section 65(2) a balancing test (not seen in *Clafin*) to be applied when a beneficiary seeks to terminate or modify a trust. Section 65 provides as follows (in brackets is language we believe is necessarily implied):

Termination or Modification by Consent of Beneficiaries

(1) Except as stated in Subsection (2), if all of the beneficiaries of an irrevocable trust consent, they can compel the termination or modification of the trust.

(2) If termination or modification of the trust under Subsection (1) would be inconsistent with a material purpose of the trust, the

beneficiaries may remove a trustee, not only for breach of trust, but also for persistent failure or unwillingness to administer the trust effectively if the court finds removal best serves the interests of the beneficiaries.¹¹ According to the Comments to Section 706, a “long-term pattern of mediocre performance, such as consistently poor investment results”¹² could show “persistent failure,” whereas “a pattern of indifference to . . . the beneficiaries”¹³ could demonstrate “unwillingness.”

In many civil law jurisdictions, the functions of the modern Anglo-American trust are covered under the rubric of the law of obligations.¹⁴ In contrast to the general Anglo-American view that the trust is a property arrangement, these jurisdictions see the “trust” as in essence a third party beneficiary contract between the settlor and the trustee for the benefit of the beneficiary.¹⁵ Seen contractually, the third party beneficiary, under provisions

beneficiaries cannot compel its termination or modification except with the consent of the settlor or, after the settlor’s death, with authorization of the court if it determines that the reason for termination [or modification] outweighs the material purpose.

RESTATEMENT (THIRD) OF TRUSTS § 65 (Tentative Draft No. 3, 2001). The Reporter’s Notes clarify that Section 65 applies to the question of trustee removal, which is apparently a species of trust modification under Section 65. RESTATEMENT (THIRD) OF TRUSTS § 65 cmts. d & f (Tentative Draft No. 3, 2001). In Section 65, the interests of the beneficiary are weighed against the purposes to be achieved by the settlor. See RESTATEMENT (THIRD) OF TRUSTS § 65(2) (Tentative Draft No. 3, 2001). Such a balancing test suggests that dead hand control in this area is now less important to the restaters than it was previously.

11. Section 706 of the Uniform Trust Code provides in pertinent part that: the court may remove a trustee if . . . because of unfitness, unwillingness, or persistent failure of the trustee to administer the trust effectively, the court determines that removal of the trustee *best serves the interests of the beneficiaries*

UNIF. TRUST CODE § 706(b)(3) (2000) [hereinafter UTC] (emphasis added).

12. UTC § 706(b)(3) cmt.

13. UTC § 706(b)(3) cmt.

14. See *infra* notes 15, 105, and accompanying text. In third party beneficiary language, the settlor would be promisee, the trustee would be promisor, and the beneficiary would be the third party for whom the contract is enforced.

15. As to trusts as property-based, see, for example, RESTATEMENT (SECOND) OF TRUSTS § 2 (1959).

For the traditional European view, see A. Borrás & C. Gonzalez Beilfuss, *National Report for Spain*, in PRINCIPLES OF EUROPEAN TRUST LAW 163 (D.J. Hayton et al. eds., 1999) (Pension and investment funds, which are becoming more popular in Spain, involve the holding and administration of assets for the beneficiaries pursuant to obligations, as determined by contract.); H. Kötz, *National Report for Germany*, in PRINCIPLES OF EUROPEAN TRUST LAW, *supra*, at 89, 100 (The *treuhänder* is Germany’s

such as are contained in UTC Section 706, would be enforcing its right to effective and attentive trust administration by attempting to replace the promisor/trustee.

Believing that a comparative law approach often helps illuminate problems in our own system, we decided to consider a contractual analysis of the trustee removal problem. We agree with Professor John Langbein that the modern trust, especially the one between the settlor and a corporate or another institutional trustee, is essentially a deal: it involves a contract about how property is to be managed and distributed.¹⁶

What is more, this trust deal looks very much like a third party beneficiary contract. Until a statutory change in 1999,¹⁷ England denied the existence of such contracts unless the rights of the beneficiary were specifically held in trust. While third party beneficiary contracts were generally upheld in the United States during the twentieth century, until 1979 Massachusetts employed the

version of the trust. It is a contractual agreement between the settlor and the “trustee” (*treuhander*) for the benefit of a third party (the beneficiaries) and is governed by the general rules of contract law.); H.L.E. Verhagen, *Trusts in the Civil Law: Making Use of the Experience of ‘Mixed’ Jurisdictions*, 3 EUR. REV. OF PRIVATE L. 477, 495 (2000) (In the Netherlands, the relationship between the trustee and the beneficiary is obligational in character, with the underlying basis of the trust being a contract between the settlor and trustee for the benefit of a third party (the beneficiary). In South Africa, a beneficiary’s rights under a trust agreement is treated as contractual based on elements of third party beneficiary contract law.).

16. See John H. Langbein, *The Contractarian Basis of the Law of Trusts*, 105 YALE L.J. 625, 627, 639 (1995) [hereinafter Langbein, *Contractarian*]. The “trust deal” between settlor and trustee is what creates the trust. It shares two of the defining characteristics of the contract: voluntary formation and party autonomy over its terms. See *id.* at 650. Because the beneficiaries are intended to benefit from this trust deal, the trust is the functional equivalent of the third party beneficiary contract. See *id.* at 627. For more on the functional approach to legal doctrine, see Ronald Chester & Scott E. Alumbaugh, *Functionalizing First-Year Legal Education: Toward a New Pedagogical Jurisprudence*, 25 U.C. DAVIS L. REV. 21 (1991). For support of the “trust as contract” position from believers in law and economics, see Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 J.L. & ECON. 425 (1993).

When Professor Chester asked Professor Langbein about the problem of trustee removal, Professor Langbein admitted that it was a knotty one in American law, but expressed no opinion on whether his contractarian analysis of trust law would shed light on it. See E-mail from John Langbein, Professor of Law and Legal History, Yale University, to Professor Ronald Chester, Professor of Law, New England School of Law (Dec. 2000) (on file with Authors). We believe that there is utility in using the contractarian lense in examining this issue and will employ it where helpful throughout this Article. See *infra* notes 72-117 and accompanying text.

17. See generally Contracts (Rights of Third Parties) Act, 1999, c. 31 (Eng.) (England now recognizes third party beneficiary contracts.).

English common law rule disallowing them unless they appeared to establish a trust.¹⁸ Although third party beneficiary contracts were ultimately allowed to be independent of an established trust, their basis in trust law seems undeniable.

While new law, such as the UTC, seldom recognizes explicitly the relationship between third party beneficiary contract and trust, often the connection is implicit. For example, the term “interests of . . . the beneficiaries,”¹⁹ which is employed in the trustee removal section (Section 706), is defined elsewhere in the Code as “the beneficial interests provided in the terms of the trust itself.”²⁰ Thus, the “trust deal,”²¹ not outside factors, determines the beneficiaries’ rights; their rights and interests, thus, originate in the contract. The trust agreement also can be understood as a relational contract, generally of long duration and, thus, subject to various changes of circumstance.²² “A contract is relational to the extent that parties are incapable of reducing important terms of the arrangement to well-defined obligations.”²³ Thus, in the trust deal, the parties must adjust their relationship over time through the exercise of discretion. Surely, the trustee makes such discretionary moves. Whether the beneficiary, if seen as a third party beneficiary to the trust deal, has similar discretion to adjust the relationship is an interesting question in the context of trustee removal. In any event, the concept of relational contract, like that of third party beneficiary contract, provides us a useful lense with which to examine the trustee removal problem.

A practical reason reformers are looking for a way to untie *Clafin*’s knot around trustee portability stems from the recent changes in the banking industry.²⁴ Dissolution, merger, and the selling of trust accounts, with or without such corporate changes, certainly indicate that bank trustees no longer regard their “contracts” with the average settlor as sacrosanct.²⁵ Why should American

18. See Choate, Hall & Stewart v. SCA Serv., 392 N.E.2d 1045 (Mass. 1979); see also E. ALLAN FARNSWORTH, CONTRACTS § 10.2, at 747 n.24 (1982); John D. Hughes, Note, *The Third Party Beneficiary Role in Massachusetts*, 8 SUFFOLK U. L. REV. 130, 140, 143 (1973).

19. UTC § 706(b)(3)-(4).

20. UTC § 103(7).

21. See Langbein, *Contractarian*, *supra* note 16, at 627.

22. See generally Ian R. Macneil, *Contracts: Adjustments of Long-Term Economic Relations Under Classical, Neoclassical, and Relational Contract Law*, 72 NW. U. L. REV. 854 (1978).

23. Charles J. Goetz & Robert E. Scott, *Principles of Relational Contracts*, 67 VA. L. REV. 1089, 1091 (1981).

24. See *infra* note 32 and accompanying text.

25. See *infra* note 32 and accompanying text. See generally Jennings v. Fid. & Columbia Trust Co., 41 S.W.2d 537 (Ky. 1931) (court appointment of a special receiver to administer trust estates during the reorganization of a trust company); Application of

law protect this “contracted” relationship when the trustees themselves are free to alter it at will? Because today’s banking industry is engaged in such large volumes of trust asset transfers and sales from bank to bank, the *Clafin* doctrine seems too restrictive of beneficiaries’ rights to play the corporate fiduciary market. It strikes us that beneficiaries should have much the same right to use market mechanisms as do banks. Shopping for a better corporate trustee (if not necessarily an individual one, who might be too easily manipulated by the beneficiaries) seems to us a right that, within limits, beneficiaries ought to have.

What then of this “contract” between settlor and trustee? Should it remain sacrosanct? One argument might be, as was advanced in the recent case of *Matter of May C. Hogan Trust*²⁶ (“*Hogan*”), that there is an implied term in the trust contract that the beneficiary (for whose benefit the contract is made) can ordinarily compel removal of one corporate trustee in favor of another without violating a material purpose of the settlor.²⁷ Secondly, because a trustee can die or be replaced, the trust itself, not its incumbent trustee, is the ultimate promisor under the contract.²⁸ This may provide the beneficiary with rights and interests under the trust contract that are superior to those of a particular trustee, including a right to replace a corporate trustee without undue difficulty.

In this Article, we hope to show that viewing trust law through a contractual lense may illuminate the problem of beneficiary removal of a corporate trustee. In part, this lense can help clarify by examining the recent reforms in American

Cont’l Bank & Trust Co. of N.Y., 82 N.Y.S.2d 214 (N.Y. 1948) (a corporate trustee that voluntarily dissolves should resign its trusteeships and accounts); *In re Nat’l Bank of Fayette County*, 47 Pa. D. & C. 47 (Ct. Com. Pl. 1943) (The receiver of a national bank serving as a trustee does not become the trustee in place of the bank but is under a duty to take possession and conserve the assets of the trust accounts until a successor trustee is appointed.).

The laws governing merger, consolidation, and conversion are largely statutory. See, e.g., MASS. GEN. LAWS ANN. ch. 172, § 36(D) (Law. Co-op. 2002) (The continuing trust company into which a trust or banking company has been merged or consolidated is considered the same corporate entity as that of the consolidating or merging institution.); N.Y. BANKING LAW § 604-a (McKinney 2001) (regarding transfer of fiduciary relationships of a banking institution).

26. Letter Opinion from Glen A. Severson, Circuit Court Judge, Circuit Court of South Dakota, Second Judicial Circuit, to counsel regarding *In re May C. Hogan Trust*, Trust No. 84-17 (Nov. 10, 1999) [hereinafter *Hogan*] (on file with the Circuit Court of South Dakota, Second Judicial Circuit).

27. See *id.* at 3.

28. A trust has its existence independent of a trustee. Equity will not allow a trust to fail for want of a trustee. RESTATEMENT (SECOND) OF TRUSTS §§ 32, 33 (1959); GEORGE T. BOGERT, TRUSTS § 29 (6th ed. 1987). Trustees therefore, as administrators of the trust, are mere holders of an office. See Kenneth G.C. Reid, *Patrimony Not Equity: The Trust in Scotland*, 3 EUR. REV. OF PRIVATE L. 427, 434 (2000).

trust law (as seen in the UTC and the *Restatement (Third) of Trusts*), as well as the contractual approach of European civil law jurisdictions²⁹ and their recent attempts to move beyond it.³⁰

Along the way, we will explore what rights the trust deal may provide beneficiaries in the trustee removal area. For example, a corporate trustee performs certain non-personal duties that are associated with the office of the trustee. These duties, particularly those involving investment of trust assets and administration, are a primary focus of the trust deal and generally may be accomplished by any other corporate trustee. Perhaps, the settlor's trust deal contemplated that beneficiaries should have the right to transfer a trust from one corporate trustee to another of their choosing if they can convince the court that this change would be in their best interests. A corollary of this interpretation might be that such a change would not contravene any material purpose of the settlor, as the court found in *Hogan*.³¹

II. CURRENT TRUSTEE REMOVAL LAW

As banks continue to merge, consolidate, and dissolve, trust funds are transferred daily from bank to bank as part of the banking industry's normal course of business.³² Some beneficiaries argue that the fees that banks charge to administer trust accounts are unjustified in light of the services (or lack thereof) that banks provide to beneficiaries.³³ These fees, indeed, can be hard to

29. While trustee removal does not seem to be a primary concern in the civil law jurisdictions (their primary concern is trustee insolvency), see Verhagen, *supra* note 15, at 486, viewing the trust relationship as contractual (*i.e.*, under the civil law of obligations) may illuminate trustee removal under American law.

30. See, e.g., 2 HAGUE CONFERENCE ON PRIVATE INTERNATIONAL LAW, PROCEEDINGS OF THE FIFTEENTH SESSION: TRUSTS—APPLICABLE LAW AND RECOGNITION 361 (1985) [hereinafter 2 HAGUE CONFERENCE]; PRINCIPLES OF EUROPEAN TRUST LAW, *supra* note 15; see also *infra* notes 101-32 and accompanying text.

31. See *Hogan*, *supra* note 26, at 3.

32. See, e.g., Richard F. Freeman, *Bank Trustee Transfers of Charitable Trusts*, 6 AMERICA'S COMMUNITY BANKERS, June 1997, at 17; James R. Kraus, *State Street's Unit Trust Servicing Business Reportedly Cost Bank of N.Y. \$15M to \$30M*, THE AMERICAN BANKER, Mar. 4, 1996, at 12; *Corporate Trust Market Shrinks Due to Technology, Competition*, 4 TREASURY MANAGER'S REPORT, Mar. 15, 1996; *Laurentian Bank Finalizes Acquisition of National Trust's Dealer Trustee Services Portfolio*, CANADIAN CORPORATE NEWSWIRE, May 19, 1998; *The Bank of New York Announces the Acquisition of the Corporate Trust Business of Harris Trust and Savings Bank*, PR NEWSWIRE, Mar. 27, 2000.

33. See EDMUND A. MENNIS, TRUST DEPARTMENT MANAGEMENT MANUAL (Sheshunoff Information Services, Inc. 1990); see also L. Anne Allen & Rick G. Swygman, *When It Comes to Pricing Your Services, Are You a Sitting Target?*, 136

justify, especially where little investment expertise has been exercised, there is little diversity of investment, or the institutional trustee invests in its own accounts, such as proprietary mutual funds.³⁴

Yet, absent a breach of trust, current American trust law generally backs the banks in such matters. However, if beneficiaries were allowed to switch easily from one corporate trustee to another without having to show breach of trust or some other substantial cause, banks would be forced to compete, driving down administrative costs and fees, while, at the same time, allowing beneficiaries to seek more productive investing and more cost-effective trust administration.³⁵

TRUSTS & ESTATES 26 (July 1997); *Developing a Basis for a Class Action Challenging a Bank's Compensation Received for Managing Personal Trusts*, HEIRS®, May 22, 1998; Gil Weinreich, *How Banks Can Make the Most of Fee-Based Income*, THE AMERICAN BANKER, Mar. 12, 2001, at A14.

34. See *A Pox on Beneficiaries—The Conversion of Common Trust Funds into Proprietary Mutual Funds*, FIDUCIARY FUN. (May 1998); Ronald A. Sages et al., *Considerations in Choosing a Common Investment Alternative; Banks and Proprietary Mutual Funds*, 133 TRUSTS & ESTATES 45 (Mar. 1994).

35. HEIRS® has challenged current American trustee removal law. It asserts that major changes in the law must be made to protect the interests of the beneficiaries. Some of the more important changes include easy removal of trustees and limitations on the rights of fiduciaries to use trust assets for defense of their offices. See, e.g., Letter from Standish H. Smith, Founder of HEIRS®, to Beneficiaries of Bank Managed Personal Trusts and Members of HEIRS® Law Professor Advisory Panel 1 (Feb. 13, 2001) [hereinafter Letter to Beneficiaries] (on file with Authors). Under current law, trustees who are successful in defending the trust or applications for their removal may use trust assets as reimbursement for their defense costs. See BOGERT, *supra* note 28, § 160, at 573 nn.26 & 27. HEIRS® has proposed changing the law so that a trustee will not be allowed reimbursement from trust funds to recover its legal costs and fees prior to adjudication or without authorization by all the beneficiaries. See *infra* notes 39, 40, and accompanying text. HEIRS® argues for a restructuring of the award of costs and fees, permitting beneficiaries to recover them from the trustee and prohibiting a trustee from using trust funds to pay for its defense if it loses. HEIRS® suggests that this restructuring would not impose unwarranted costs on a corporate trustee. See, e.g., Letter from Standish H. Smith, Founder of HEIRS®, to Edward C. Halbach, Jr., Professor Emeritus at School of Law, University of California, Berkeley 1-2 (May 26, 2001) (on file with Authors). As the administration of a trust account is a commercial enterprise, the bank, as corporate trustee, should bear some risk in its acceptance and performance as trustee. Knowing that it will not be able to seek reimbursement in its defense of an action brought against it, a corporate trustee could be encouraged to perform at a higher standard, or at least to refrain from substandard performance. It also could encourage a corporate trustee to comply with beneficiary requests for resignation. HEIRS® believes that beneficiary complaints about trustee performance are often legitimate, and a restructuring of the award of fees and costs would not subject a trustee to frivolous lawsuits. See *id.*

In addition, active beneficiary participation in the management of their trust accounts allows freer movement of account assets in the market.

Thus, in continuing to hold the settlor's intent paramount under *Clafin*, American courts and lawmakers are tying the hands of the beneficiaries, whose interests the settlor was originally concerned with promoting.³⁶ To say that a settlor, by naming in his trust a particular bank as trustee, intended a special relationship with that trustee, may result in unintended dead hand control disadvantaging the beneficiaries. Even if the settlor named his hometown bank to serve as trustee, relying on a personal relationship as his basis for selecting that bank as trustee, the recent wave of bank mergers (an event the settlor most likely did not contemplate) may destroy both this special relationship and undercut the settlor's primary reason for selecting the bank.³⁷ Yet, trust assets are transferred with relative ease to a merged institution, with the beneficiaries having little—if any—say in the matter.³⁸

At the state level, law reform in this area has been nearly nonexistent. For example, at the behest of HEIRS®, Senator Stewart J. Greenleaf (R-Penn.) introduced a bill in 1997 that proposed amending Title 20 (Decedents, Estates and Fiduciaries) of the Pennsylvania statutes by adding a section providing for easier removal and replacement of a trustee.³⁹ The bill required that courts

36. See generally *Allen v. First Nat'l Bank & Trust Co. of Green Field*, 67 N.E.2d 472 (Mass. 1946) (holding that it was the intent of the testator that the trust created for the benefit of the petitioner continue "during the full term of her natural life," and, therefore, the trust could not be terminated even with the approval of all parties in interest); *West v. Third Nat'l Bank of Hampden County*, 417 N.E.2d 991 (Mass. App. Ct. 1981) (holding that the seventy-one-year-old petitioner, who was the sole beneficiary of a trust for her support and who was under no incapacity, could not compel termination of the trust because to do so would be contrary to the intention of the settlor); *In re Ulansey's Estate*, 73 Pa. D. & C.2d 453 (Ct. Com. Pl. 1975) (holding that, pertaining to trustee removal, the testator's intent is primary and the desires of the beneficiaries are secondary as their interest derives solely from the gift of the testator).

37. See *supra* note 3 and accompanying text; Letter from Standish H. Smith to Office of the Chief Counsel, Division of Corporate Finance, Securities and Exchange Commission 4 (Feb. 15, 1996) (on file with Authors).

38. See *supra* notes 32-33.

39. The bill provided in pertinent part:

§ 7122. Removal and replacement of corporate or individual trustee.

(a) Court approval necessary to replace. Upon petition by the sui juris beneficiaries of a trust, the settlor of which is deceased, voting so that each income beneficiary shall cast two votes, each remainder beneficiary to cast one vote, with income interests to break ties, a court of appropriate jurisdiction shall remove and replace an incumbent trustee (individual, corporate or other entity) with a corporate trustee whether or not grounds exist for removal under section 7121 (relating

remove and replace an incumbent trustee, whether or not for cause or any breach of trust, upon a vote of the beneficiaries and a petition to the appropriate court.⁴⁰ Whatever the theoretical arguments for the bill, thus far the banks have had the political clout to block it, protecting their right to maintain control over a particular trust if they so desire, even in HEIRS'® home state.⁴¹

A. *The Claflin Doctrine and Its Effects on the Issue of Trustee Removal*

The *Claflin* doctrine, which is followed by a majority of the states, declares that, even if all beneficiaries consent, they may not compel termination (or, by implication, modification) of a trust if to do so would be inconsistent with a material purpose of the trust.⁴² As a corollary, the general rule in American trust

to grounds and procedure).

...

(c) Reasonable costs.

(1) The reasonable legal and accounting expenses and the costs of expert witnesses of an incumbent trustee shall be charged to that trustee.

(2) Regardless of the outcome of the proceeding, under no circumstances shall the trustee be entitled to charge a termination or other fee or be reimbursed by the trust or the beneficiaries or other trustees for its costs or those of any third party.

(d) Substantial change in ownership or management of corporate trustee. Any argument made against removal of a trustee which is based on a presumption that the trust settlor had special confidence in the trustee may be rebutted by a showing of substantial change of ownership or management of the trustee subsequent to the trust's creation.

...

S. 994, Reg. Sess. (Pa. 1997).

40. For the language of proposed § 7122(a), see *supra* note 39.

41. See, e.g., Letter to Beneficiaries, *supra* note 35, at 2 ("Long standing HEIRS® members will recall that our efforts over five years to pass a 'practical portability' bill in Pennsylvania could not overcome bank opposition."); see also STANDISH H. SMITH, HEIRS® ORGANIZATION, PERSONAL TRUST FROM AN ANTI-TRUST POINT OF VIEW 9 (Aug. 3, 1998) (After six years of opposition, the Pennsylvania Bankers Association successfully opposed the HEIRS®-sponsored Pennsylvania bill, see *supra* note 39, which, if passed, would have given beneficiaries the right to replace an unsatisfactory corporate trustee without having to show a breach of trust.).

42. *Claflin v. Claflin*, 20 N.E. 454, 455-56 (Mass. 1889). In *Claflin*, the court distinguished the earlier case of *Sears v. Choate*, 15 N.E. 786 (Mass. 1888), as follows:

In *Sears v. Choate* it is said: Where property is given to certain persons for their benefit, and in such a manner that no other person has or can have

law is that a court will not remove a trustee merely because the beneficiaries want to do so.⁴³ Absent authority in the trust instrument or a showing of breach of trust by the trustee or some other substantial cause, the beneficiaries will have difficulty in removing a trustee.⁴⁴

However, in its discretion, a court may remove a trustee if its continuing to act in that capacity would be detrimental to the trust.⁴⁵ Unless the trustee is performing in such a way as to be detrimental to the administration of the trust,

any interest in it, they are in effect the absolute owners of it; and it is reasonable and just that they should have the control and disposal of it, unless some good cause appears to the contrary. In that case the plaintiff was the absolute owner of the whole property, subject to an annuity of \$10,000, payable to himself. The whole of the principal of the trust fund, and all of the income not expressly payable [via the annuity] to the plaintiff, had become vested in him . . . by way of resulting trust as property undisposed of by the [settlor's] will. Apparently, the testator had not contemplated such a result, and had made no provision for it, and the court saw no reason why the trust should not be terminated, and the property conveyed to the plaintiff . . . In the case at bar nothing has happened which the testator did not anticipate, and for which he has not made provision. It is plainly his will that neither the income nor any part of the principal [beyond certain periodic payments] should now be paid to the plaintiff. It is true that the plaintiff's interest is alienable by him, and can be taken by his creditors to pay his debts, but it does not follow because the testator has not imposed all possible restrictions that the restrictions which he has imposed should not be carried into effect.

The decision [validating spendthrift trusts] in [*Broadway National Bank v. Adams*, 133 Mass. 170 (1882)], rests upon the doctrine that a testator has a right to dispose of his own property with such restrictions and limitations, not repugnant to law, as he sees fit . . . [F]or the reasons there given we are unable to see that the directions of the testator to the trustees to pay the money to the plaintiff when he reached the age of 25 and 30 years are against public policy, or are so far inconsistent with the rights of property given to the plaintiff, that they should not be carried into effect. It cannot be said that these restrictions upon the plaintiff's possession and control of the property are altogether useless, for there is not the same danger that he will spend the property while it is in the hands of the trustees as there would be if it were in his own . . . The existing situation is one which the testator manifestly had in mind, and made provision for.

Clafin, 20 N.E. at 455-56.

43. See RESTATEMENT (SECOND) OF TRUSTS § 107 (1959); 2 AUSTIN W. SCOTT & WILLIAM F. FRATCHER, THE LAW OF TRUSTS § 107.3 (4th ed. 1987).

44. See RESTATEMENT (SECOND) OF TRUSTS § 107 (1959).

45. See *id.* See generally *Getty v. Getty*, 252 Cal. Rptr. 342 (Ct. App. 1988); *Grant v. Grant*, 734 So. 2d 68 (La. Ct. App. 1999); *Steele v. Kelley*, 710 N.E.2d 973 (Mass. App. Ct.), *review denied*, 714 N.E.2d 354 (Mass. 1999).

mere friction between the trustee and the beneficiary is not a sufficient ground for removing the trustee.⁴⁶

In England, the landmark trust modification case of *Saunders v. Vautier*⁴⁷ is contrary to the *Clafin* doctrine. In *Saunders*, the court concluded that, because the beneficiary had the entire beneficial interest with no gift over on death before reaching the required age of twenty-five, he was entitled to require distribution of principal and accumulated income the moment he came of age (twenty-one) and acquired the capacity to give the trustee a valid discharge.⁴⁸ Thus, English law is said to favor the interests of the beneficiaries in trust modification cases; one also would infer that, under English law, trustee removal (a form of modification) should serve the interests of the beneficiaries, not the settlor.

However, English courts do not allow easy removal of a trustee by the beneficiaries. The course of action available to the beneficiaries is to terminate the trust and distribute the trust funds either to themselves or to another trust instrument with a new trustee.⁴⁹ When establishing a new trust, however, beneficiaries face tax consequences.⁵⁰ This may serve as its own deterrent when English beneficiaries consider trust termination as a means of trustee removal.

B. The UTC and Restatement (Third) of Trusts May Provide Beneficiaries with an Easier Means of Trustee Removal

In response to beneficiary protest regarding the difficulties in removing a corporate trustee, recent reforms in American trust law have been promulgated. As mentioned above, Section 706 of the UTC permits beneficiaries to remove a trustee for failure or unwillingness to administer the trust properly if the court finds trustee removal best serves the interests of the beneficiaries.⁵¹ This

46. See RESTATEMENT (SECOND) OF TRUSTS § 107 cmt. c (1959).

47. 41 Eng. Rep. 482 (Ch. 1841).

48. See *id.*

49. See generally *Re Brockbank*, Ward v. Bates, 1 All E.R. 287 (1948); *infra* notes 69, 70, and accompanying text.

50. “[Establishing a new trust] . . . would probably attract an *ad valorem* stamp duty, and . . . [on these facts] the benefit of the exemption from estate duty . . . on the death of the widow as a surviving spouse would be lost.” *Re Brockbank*, 1 All E.R. at 288.

51. In its entirety, Section 706 reads as follows:

(a) The settlor, a cotrustee, or a beneficiary may request the court to remove a trustee, or a trustee may be removed by the court on its own initiative.

(b) The court may remove a trustee if:

(1) the trustee has committed a serious breach of trust;

(2) lack of cooperation among cotrustees substantially impairs the

emphasis on the beneficiaries' interests appears without the *Clafin* bar in Section 706(b)(3) and, as a limitation on the *Clafin* rule in the "changed circumstances" provision, Section 706(b)(4).⁵²

Section 706(b)(3) provides several bases for removal, including "unwillingness" or "persistent failure of the trustee to administer the trust effectively."⁵³ Presumably, this Section responds to complaints of indifference by the trustee, as well as to actual inefficiency of trust administration and poor investment performance.⁵⁴ Under this provision, a practitioner representing beneficiaries unsatisfied with a corporate trustee's management of the trust and the diligence of its performance may have a greater chance of successfully removing a trustee than under prior law.

Another example of American trustee removal reform is found in Section 65 of the *Restatement (Third) of Trusts*.⁵⁵ Section 65(2) is distinct from English

administration of the trust;

(3) because of unfitness, unwillingness, or persistent failure of the trustee to administer the trust effectively, the court determines that removal of the trustee *best serves the interests of the beneficiaries*;

or

(4) there has been a substantial change of circumstances or removal is requested by all of the qualified beneficiaries, the court finds that removal of the trustee *best serves the interests of all of the beneficiaries* and is not inconsistent with a material purpose of the trust, and a suitable cotrustee or successor trustee is available.

...

UTC § 706 (emphasis added); *see supra* notes 11-13 and accompanying text.

52. UTC § 706(b)(3)-(4).

53. UTC § 706(b)(3). According to Professor Langbein:

This measure responds to the concern that under traditional law beneficiaries have had little recourse when trustee performance has been indifferent, but not so egregious as to be in breach of trust. The Official Comment says "A persistent failure to administer the trust effectively" might include a long-term pattern for mediocre performance, such as consistently poor investment results when compared to comparable trusts.

John H. Langbein, *The Uniform Trust Code: Codification of the Law of Trusts in the United States*, 15 TR. L. INT'L 66, 76 (2001) [hereinafter Langbein, *The UTC*].

54. According to the Comment to Section 706, the "unwillingness" of the trustee to administer the trust effectively may include a "pattern of indifference to some or all of the beneficiaries." UTC § 706 cmt. This may prove an easier test for some beneficiaries to meet than that of "persistent failure" by the trustee.

55. Section 65 provides as follows:

TERMINATION OR MODIFICATION BY CONSENT OF BENEFICIARIES

(1) Except as stated in Subsection (2), if all of the beneficiaries of an irrevocable trust consent, they can compel the termination or

law⁵⁶ in that it recognizes the *Claflin* doctrine; however, it weakens *Claflin*'s grip through the creation of a balancing test.⁵⁷ It states that, if termination or modification of the trust would be inconsistent with a material purpose of that trust, the beneficiaries cannot compel its termination or modification unless the court determines that the reason for termination (or modification) outweighs that material purpose.⁵⁸ Like Section 706 of the UTC, the balancing test in Section 65 represents a degree of reform in American trust law.⁵⁹ If followed, Section 65 significantly could increase beneficiaries' ability to remove a trustee.

The Reporter's Notes to Section 65 contain the following language: "Although a trust may have a material purpose that would preclude complete or even partial termination of the trust, a particular modification agreed to by the beneficiaries might not be inconsistent with any material purpose of the trust."⁶⁰

modification of the trust.

(2) If termination or modification of the trust under Subsection (1) would be inconsistent with a material purpose of the trust, the beneficiaries cannot compel its termination or modification except with the consent of the settlor or, after the settlor's death, with authorization of the court if it determines that the reason for termination outweighs the material purpose.

RESTATEMENT (THIRD) OF TRUSTS § 65 (Tentative Draft No. 3, 2001). The *Restatement (Third) of Trusts* was approved during the 2001 Annual Meeting of the American Law Institute, May 14-17, 2001, at Mayflower Hotel, Washington, D.C.:

Subject to the discussion at the meeting and to final editorial revisions, Tentative Draft No. 3 of Restatement Third, Trusts, was approved. This motion of approval, initially adopted in a split session, was subsequently affirmed in a plenary session. The draft is expected to be published, together with the previously approved material from Tentative Draft Nos. 1 and 2, in 2002.

The American Law Institute, *Actions Taken on 2001 Annual Meeting*, available at http://www.ali.org/ali/ALI2001_ActionsTKN.htm (last visited Apr. 11, 2002).

56. "In England the beneficiaries of the trust may by united action terminate the trust, notwithstanding the fact that to do so may nullify the intention of the settlor In this State it is the intention of the settlor of the trust that governs and not the desires of the beneficiaries." *Speth v. Speth*, 74 A.2d 344, 350 (N.J. 1950) (quoting *Mesce v. Gradone*, 62 A.2d 394, 396 (N.J. 1948)).

57. See RESTATEMENT (THIRD) OF TRUSTS § 65(2) (Tentative Draft No. 3, 2001).

58. See RESTATEMENT (THIRD) OF TRUSTS § 65(2) (Tentative Draft No. 3, 2001). The addition of "modification" in the parenthesis seems to us necessary to a reasonable reading of Section 65(2). See *supra* note 10 and accompanying text.

59. The comments to the UTC indicate that, unlike the *Restatement (Third) of Trusts*, the sole provision for trustee removal in the UTC is Section 706, and, thus, that it is not the subject of the more general termination and modification sections. See UTC § 411 cmt.

60. RESTATEMENT (THIRD) OF TRUSTS § 65 reporter's notes (Tentative Draft No.

The Notes indicate that a proposed modification to change a trustee may improve the administration of the trust and be more satisfactory to the beneficiaries. If it does not interfere with a material purpose of the trust, such a modification probably would be allowed.⁶¹ Thus, *Clafin* is still getting its nod, but this new *Restatement* appears to make the *Clafin* doctrine less restrictive in its effects on trustee removal.⁶²

C. Recent Case Law: The Clafin Doctrine Not a Bar to Trustee Removal

In 1999, the *Hogan* court held that the continuation in office of an incumbent corporate trustee, whose purpose was to invest trust assets and distribute the income to the trust beneficiaries, was not necessary to carry out a material purpose of the trust.⁶³ The beneficiaries of the May C. Hogan Trust sought to remove and replace Norwest Bank of South Dakota with First

3, 2001). Edward C. Halbach, Jr., Professor Emeritus at School of Law, University of California, Berkeley, is the Reporter for the *Restatement (Third) of Trusts* and has written numerous trust law publications. He is also co-editor with Eugene Scoles, Professor Emeritus at School of Law, University of Oregon, of various editions of the casebook *Decedent's Estates & Trusts*.

61. RESTATEMENT (THIRD) OF TRUSTS § 65 reporter's notes (Tentative Draft No. 3, 2001).

62. Cases supporting less concern for settlor's "material purpose" include *Ambrose v. First National Bank*, 482 P.2d 828 (Nev. 1971). In that case, the court allowed a beneficiary to terminate a trust based on the following:

We are not persuaded that the doctrine of the leading American case of *Clafin v. Clafin* . . . should rule the trust before us No reason is expressed in the trust instrument for delaying the [now adult] daughter's enjoyment following the settlor's death. No provision is made therein for the daughter's support between the ages of 21 and 28. Should the daughter die during that period of time she would be denied enjoyment of the corpus. All these factors together with a strong public policy against restraining one's use and disposition of property in which no other person has an interest . . . leads us to conclude that termination should be decreed and the beneficiary spared the expense incident to the continued administration of the trust. . . . [Absent] other circumstances to show the intention of the testator, we are of the opinion that the mere creation of the trust for successive beneficiaries did not indicate a purpose other than the preservation of the corpus for the remaindermen and, therefore, the trust may be terminated by the action here taken.

Id. at 831; see also *Bennett v. Tower Grove Bank & Trust Co.*, 434 S.W.2d 560 (Mo. 1968); RESTATEMENT (SECOND) OF TRUSTS § 337 cmt. f (1959); 2 SCOTT & FRATCHER, *supra* note 43, § 337.1.

63. See *Hogan*, *supra* note 26, at 3.

American Bank as corporate trustee.⁶⁴ The *Clafin* doctrine is codified in South Dakota.⁶⁵ The beneficiaries, all of whom consented to the modification, claimed that the modification (removal and replacement of the corporate trustee) should be allowed because it did not interfere with a material purpose of the trust.⁶⁶

The *Hogan* court found that the provisions of the trust represented a contract between the settlor and trustee. Further, the trust contract was not written for the benefit of the trustee.⁶⁷ The court then held that the continuation of Norwest as corporate trustee was not necessary to carry out a material purpose of the trust, stating:

[I]t is not necessary for Norwest to invest and distribute the Trust assets and distribute the income to the Beneficiaries. These functions can be carried out by another trustee. Consequently, continuing the Trust with Norwest as the trustee is not necessary to carry out the material purposes of the Hogan Trust.⁶⁸

If followed, this case, using the “material purpose” test affirmatively to allow replacement of a corporate trustee rather than negatively to restrict replacement, signifies an important reform in the trustee removal area. Moreover, by mixing contract and trust law to achieve this result, it illustrates one of the overriding themes of this Article.

Considering the results in *Hogan*, one must ask whether the *Clafin* doctrine should have any application to corporate trustees. If the underlying purpose of the *Clafin* doctrine is to protect the intent of the settlor in his selection of a trustee (which intent seemingly is clearer when an *individual* trustee is selected), then the rationale for *Clafin* in today’s market seems misplaced. The selection of a corporate trustee should not be regarded as a personal contractual relationship between the settlor and the corporate trustee when that trustee voluntarily may sell the assets to another bank, resign as corporate trustee, merge with another corporation, or otherwise relieve itself of its trusteeship. Simply put, as held in *Hogan*: it is not material to the purpose of the trust for a particular

64. See *Hogan*, *supra* note 26, at 1.

65. The relevant South Dakota statute provides, in pertinent part, that “[a]n irrevocable trust may be modified or terminated upon the consent of all of the beneficiaries if continuance of the trust on its existing terms is not necessary to carry out a material purpose. . . .” S.D. CODIFIED LAWS § 55-3-24 (Michie 2001).

66. See *Hogan*, *supra* note 26, at 2.

67. See *Hogan*, *supra* note 26, at 3. Presumably, it was written for the benefit of the (third party) beneficiary.

68. *Hogan*, *supra* note 26, at 3. However, the court indicated that, in the future, determination of whether removal violated a “material purpose” would have to be decided on a case-by-case basis.

corporate trustee to serve as trustee when another corporate trustee could perform the same function.

D. *The English Law of Trustee Removal*

While American and English trust law are similar in most respects, one difference lies in the treatment, respectively, of the interests of the settlor and the beneficiaries. In the United States, courts tend to favor settlor intent and dead hand control. In England, the interests of the beneficiaries control:

The American cases recognize primarily the privilege of the donor to qualify his gift as he pleases within legal limits The English courts concentrate their predominate attention upon the situation of the beneficiary who being substantially the owner of the trust estate should be permitted in their judgment to deal with it as he wishes

⁶⁹

Despite their emphasis on the rights and interests of the beneficiaries, the English courts, as previously indicated, do not easily allow trustee removal. In *Re Brockbank*,⁷⁰ the beneficiaries of a trust unanimously favored removal of a successor trustee without his consent and the appointment of a bank as sole trustee in his place, and the court indicated that the beneficiaries were not allowed to remove the trustee without first terminating the trust.⁷¹ It appears that English courts, although not directly protective of the settlor's intent, *are*

69. *Speth v. Speth*, 74 A.2d 344, 347 (N.J. 1950). According to the *Speth* court: "The English authorities are of no force here because of our fundamentally divergent view of the power of the settlor and the beneficiaries of a trust over the trust *Res*. In England the beneficiaries of the trust may by united action terminate, notwithstanding the fact that to do so may nullify the intention of the settlor In this State it is the intention of the settlor of the trust that governs and not the desires of the beneficiaries."

Id. at 350 (quoting *Mesce v. Gradone*, 62 A.2d 394, 396 (N.J. 1948)).

70. *Re Brockbank*, *Ward v. Bates*, 1 All E.R. 287 (1948). According to an expert on English trust law, Professor David Hayton of King's College, London, *Brockbank* remains good law except in certain land trusts under Section 19 of the Trusts of Land and Appointment of Trustees Act of 1996. See E-mail from David Hayton, *supra* note 8. *But see Re Henderson*, *Henderson v. Henderson*, 3 All E.R. 295 (1940).

71. See *Re Brockbank*, 1 All E.R. at 288. Except under Section 19 of the Trusts of Land and Appointment of Trustees Act 1996, the beneficiaries (even if all ascertained, unanimous, and of full capacity) cannot compel the trustees to retire and appoint new trustees or to do anything other than terminate the trust and convey the trust property (belonging wholly to the beneficiaries) to the beneficiaries or their nominees. See E-mail from David Hayton, *supra* note 8.

protective of the trust as established and, perhaps for reasons of administrative efficiency, are not keen on allowing beneficiaries to change horses in midstream, unless they want to establish a new trust.

III. A CONTRACTUAL ANALYSIS OF THE TRUSTEE REMOVAL PROBLEM

A. *The Contractual Lense: A Comparative Law Perspective*

Most civil law systems handle trust-like situations with what may be seen as a third party beneficiary contract, under which the trustee owns the property and administers it for the benefit of the third party (only the Dutch and South African *bewind*⁷² places ownership in the beneficiary). Thus, a central problem in most civil law jurisdictions is that beneficiaries cannot *own* anything—there is no concept of split legal/equitable ownership. The beneficiary becomes simply another creditor of the trustee unless the Scottish system of separate patrimonies (trust and personal) is adopted.⁷³

In general, persons acting as trustees in civil law systems do not hold a continuing “office” in the same sense as trustees in the Anglo-American trust systems.⁷⁴ In such civil law arrangements, the “trusteeship” dies with the individual holding it, unless the civil law concept is modified.⁷⁵ Because, in the

72. See *infra* note 132.

73. The Scots have a mixed system of trust law comprising elements of both common law and civil law. See Reid, *supra* note 28, at 428. In the mixed Scot system, the fundamental characteristic of a trust is not dual ownership, but rather dual patrimony. See Reid, *supra* note 28, at 428, 431-32. This dual patrimony provides beneficiaries with the same protection from trustee insolvency as the common law trust. See Reid, *supra* note 28, at 432. As described by Professor Reid, each person has only one patrimony. See Reid, *supra* note 28, at 432. However, a person (trustee) who is entrusted by agreement to hold property of another for the benefit of a third party, may do so. See Reid, *supra* note 28, at 432. The holding of this property creates in the trustee another patrimony (the trust patrimony), separate and apart from the trustee’s own patrimony. See Reid, *supra* note 28, at 432. Because this trust patrimony is held by the trustee for the exclusive benefit of a beneficiary, personal creditors of the trustee may not access the assets of the trust patrimony. See Reid, *supra* note 28, at 432. Therefore, the beneficiary’s rights in the trust patrimony prevail against the private creditors of the trustee (who would recover from the trustee’s own general patrimony) simply because each has a claim to a different patrimony. See Reid, *supra* note 28, at 432.

74. See George Gretton, *Trusts Without Equity*, 49 INT’L & COMP. L.Q. 599, 617-18 (2000).

75. The *Principles of European Trust Law* modify general civil law of trusts in several ways. First, they establish the Scottish “dual patrimony” system. See PRINCIPLES OF EUROPEAN TRUST LAW, *supra* note 15, art. I (1). In describing the dual patrimony

Anglo-American system, what is involved is removal from office rather than merely from a contractual obligation, traditional civil law may have little to share, except by contrast. A new “trustee,” under even a developed trust-like concept such as the *treuhand* of Germany, would not succeed the prior trustee in a continuing office; it simply would be the “trustee” of a new (rather than a continuing) contractual agreement.⁷⁶

The contract in the Anglo-American trust can define the duties and powers of the trustee office. Thus, the settlor may include in the trust deal broad trustee removal powers in the beneficiary. If she does not, such duties and powers are implied from what Langbein views as the equivalent to the boilerplate of a

system used in Scot law, Professor Reid explains that should the trust patrimony become detached; *i.e.*, if a trustee were to resign, such resignation terminates ownership. *See Reid, supra* note 28, at 433. However, as with common law trusts, the trust assets (the trust patrimony) can be assigned to a successor trustee. A trust will not fail for want of a trustee. *See Reid, supra* note 28, at 433. A trust patrimony has a life of its own, and a court will appoint a successor trustee. *See Reid, supra* note 28, at 433.

The *Principles* also state that a trustee who is removed may be replaced. *See PRINCIPLES OF EUROPEAN TRUST LAW, supra* note 15, art. VI.

76. “[A true trustee] as the holder of an office, is removable and replaceable by the court: this is a striking contrast to purely contractual arrangements. The contrast with, say, the German *treuhand* [] is a striking one.” Gretton, *supra* note 74, at 617-18.

The *treuhand* is Germany’s version of the trust. It is a contractual agreement between the settlor and the “trustee” (*treuhander*) for the benefit of the beneficiaries and is governed by the general rules of contract law. *See Kötz, supra* note 15, at 89, 100. The contractual duty to deal with the assets as specified in the *treuhand* normally will be owed by the *treuhander* to the settlor, but if the settlor and the *treuhander* intend to confer a right to enforce the agreement on one or more third parties (the beneficiaries), such intention will take effect by way of contract for the benefit of a third party, fully recognized in German law. *See Kötz, supra* note 15, at 99. The beneficiary then may have a right to enforce the agreement by way of a direct claim against the *treuhander*. *See Kötz, supra* note 15, at 89. The *treuhander* is the sole owner of the trust assets with full and unrestricted title. *See Kötz, supra* note 15, at 93. The beneficiaries rights are the ordinary rights *in personam* of parties to a contract. *See Kötz, supra* note 15, at 93.

Interestingly, German courts do not have jurisdiction to hear trust-related matters. *See Kötz, supra* note 15, at 91. Any remedies against the *treuhander* for breach of trust are covered under contract law (*i.e.*, specific performance, injunction, or damages). *See Kötz, supra* note 15, at 102. A settlor or beneficiary has a right to terminate the “trust agreement” *for cause*. *See Kötz, supra* note 15, at 102. However, if a *treuhand* instrument fails to provide for future events, emergencies, or other conditions where the *treuhand* may be in jeopardy of smooth operation, a German court has no power “to remove or appoint a *treuhander*, to advise a *treuhander* on his rights and duties in an unexpected situation, or to permit him to deviate from the terms of the *treuhand* agreement when changed conditions make deviation essential to achievement of its primary purposes.” *Kötz, supra* note 15, at 102.

standard form contract: the default rules of trust law.⁷⁷ However, these “default rules” traditionally have not favored trustee removal absent fiduciary breach. Thus, it would seem that the most powerful way to utilize the contractual analysis would be to argue that easy trustee removal is an implied term (the equivalent of a default rule) in the trust deal. In effect, this is what the *Hogan* court in South Dakota did in allowing the beneficiaries to switch institutional trustees.

By incorporating the *Clafin* standard, the *Hogan* court implied a term that a switch of trustees would be possible if it did not violate a material purpose of the settlor: one bank or another could perform the functions the settlor had in mind;⁷⁸ the court, however, concluded that such an analysis would have to be conducted on a case-by-case basis.⁷⁹ This approach leaves open the question whether the trust contract between the settlor and a particular trustee was material to the settlor in a given case.

We submit that *Hogan* is a step in the right direction, but that presumptively its holding should be of broader applicability: the result should govern all cases where the trust beneficiaries seek to replace one institutional trustee with another, remembering that those institutions freely transfer trust accounts among themselves. The freer portability that this change would engender parallels the free transfer of trust accounts among institutions. Moreover, even if some reason were advanced that the settlor wanted a particular corporate trustee, the settlor’s right (through his executor or administrator) to continue receiving the services of that trustee would cease at the settlor’s death.⁸⁰ Any personal rights of the contracting settlor would die with his loss of control, and those rights would vest in the beneficiaries.

Therefore, it follows that, in cases where the contracting settlor is still alive, the settlor’s intent should control. According to Langbein, property law suggests that the settlor, if she has transferred the trust property without retaining control, relinquishes her right in it.⁸¹ However, using the contractual lense, he has argued that the parties’ original intention becomes paramount; thus, the parties are routinely assumed to have intended enforcement by the promisee (the settlor),

77. See Langbein, *Contractarian*, *supra* note 16, at 660.

78. See *Hogan*, *supra* note 26, at 3. Likewise, Section 65 of the new *Restatement* allows beneficiaries to use trust modification as a basis for removing a trustee if it does not violate a material purpose of the trust. See RESTATEMENT (THIRD) OF TRUSTS § 65 cmt. f (Tentative Draft No. 3, 2001).

79. See *Hogan*, *supra* note 26, at 4.

80. “Where one engages another to render services to him personally . . . [the engager’s] death . . . terminates the contract.” *Farnon v. Cole*, 259 Cal. App. 2d 855, 858 (Dep’t Super. Ct. 1968).

81. See Langbein, *Contractarian*, *supra* note 16, at 664.

as well as the beneficiary.⁸² Langbein's analysis appears to apply only to the situation where the trust is irrevocable but the settlor is not dead (or, as with a corporation, cannot die). He does not indicate whether a dead settlor's estate, under the intention standard, should have a right of enforcement. At any rate, the UTC gives the settlor standing in an action to remove a trustee, or, in certain cases, to modify or terminate a trust.⁸³

It is also noteworthy that the comments to Section 411 of the UTC indicate that the settlor's powers under that modification section are exercisable by agents such as guardians or conservators, but they say nothing about the settlor's personal representative after death.⁸⁴ Thus, it appears that, under the UTC, whatever powers the settlor has may be exercised only during his life. The trust deal, as far as he is concerned, ceases at his death.

However, the settlor's "material purposes" still continue to govern the trust under certain UTC provisions. If, after the death of the settlor, rights to proper performance by the trustee vest solely in the beneficiaries, what specific form would these rights take? Market analysis would suggest that the beneficiaries should be free to "contract out" of those services that they find to be costly and inefficient. While a trust inevitably incurs some transaction costs in the form of trustee's fees, such losses should be kept to a minimum to achieve the best use of trust assets in the market.

As a matter of law, the trust assets are now those of the beneficiaries—they, not the trustee, have the benefit of them. While it is true that the settlor set limitations on the use of these assets, or she otherwise would have granted the beneficiaries a fee, there is no real reason to assume that restrictive rules on modification, termination, and the establishment of new arrangements would be included in such restrictions. Seemingly, there is even less reason to hamper the beneficiaries' ability to maintain the same arrangement, but to attempt, as did the *Hogan* beneficiaries, to find a better, more efficient administrator for the trust assets.

Adopting a less restrictive approach like this one would leave Americans with a system that, on the surface, is like that in England: it would admit loss of settlor control of the trust after death and vest rights to the trust in the

82. See Langbein, *Contractarian*, *supra* note 16, at 664.

83. See UTC §§ 410(b), 706. Section 410(b) expressly grants the settlor standing for actions pursuant to Sections 411 and 413.

84. UTC § 411 cmt. As to charitable trusts, which are covered in Section 413, Professor Langbein has stated the following: "The Code's provision (giving the settlor standing) is not likely to make much difference . . . since charitable trusts commonly arise on the settlor's death." Langbein, *The UTC*, *supra* note 53, at 68. Because Langbein does not see settlor standing with respect to charitable trusts as extending beyond the settlor's death under the UTC, he undoubtedly has the same view as to noncharitable trusts such as would be covered by Section 471.

beneficiaries. In practice, however, it might allow even easier trustee removal than does the English system. Although English courts are charged with protecting the interests of the beneficiaries, rather than those of the settlor, they appear reluctant to grant trustee removal absent breach or termination of the trust, perhaps out of respect for smooth administration of the trust itself.⁸⁵

As we have indicated, the UTC appears to recognize that the trust deal vests third party rights in the beneficiaries. For example, under Section 706(b)(3), trustee removal on specified grounds can be had if it “best serves the interests of the beneficiaries.”⁸⁶ This subsection does not contain any additional requirement that no “material purpose” be contravened.⁸⁷ Under Section 706(b)(4), a substantial change of circumstances or the unanimous request of the beneficiaries permits removal if the court finds that this “best serves the interests of all the beneficiaries” and is not inconsistent with a “material purpose of the trust.”⁸⁸ While this inclusion of the *Clafin* test may appear to limit the third party rights of the beneficiaries, *Hogan* already has demonstrated that a court may find changing corporate trustees *not* inconsistent with a material purpose of the trust and may view such changes as serving the best interests of all of the beneficiaries. Thus, Section 706(b)(4) appears to be implying a term in the trust contract that, unless otherwise provided, removal and replacement of corporate trustees may be had to protect the rights of beneficiaries on the grounds specified in this provision.

Under the UTC, the beneficiaries of the trust deal have a right to remove the trustee for “persistent failure of the trustee to administer the trust effectively”⁸⁹ if the court determines such removal best serves the interests of the beneficiaries. Because such a failure need not rise to the level of breach of trust, this Section of the Code gives the beneficiaries a right to effective trust administration, including adequate investment performance and attention to their specific

85. Thus, the beneficiaries would not seem to have any right of removal, implied or otherwise, despite the fact that the settlor’s “contract” with the trustee, personally selecting that trustee, does not seem to control. Rather, the courts appear to exercise a sort of paternalism, generally deciding for the beneficiaries that trustee removal is not in their best interests, short of breach.

86. UTC § 706(b)(3).

87. UTC § 706(b)(3).

88. UTC § 706(b)(4). “Changed circumstances justifying removal of a trustee might include a substantial change in the character of the service or location of the trustee. A corporate reorganization of an institutional trustee is not itself a change of circumstances if it does not affect the service provided the individual trust account.” David M. English, *The Uniform Trust Code (2000): Significant Provisions and Policy Issues*, 67 MO. L. REV. 143, 199 n.232 (2002).

89. UTC § 706(b)(3).

needs.⁹⁰ It makes sense that the settlor's contract with the trustee would have included such an implied term: that the settlor would have intended that the beneficiaries have a right to effective and diligent administration by the trustee, enforceable by removal, if necessary.

B. Whose Rights Trump Whose in the Tripartite Trust Deal?

While the trust agreement can be seen as a contractual relationship between the settlor and the trustee, the beneficiary has an interest in this relationship as a third party. In her deal with the trustee, the settlor created a type of third party beneficiary contract. The trustee, as promisor, has promised the settlor to perform as required under the contract (the trust agreement) to provide for the interests of the beneficiary in exchange for a fee to be collected from the trust *res* transferred by the settlor. As an intended beneficiary of this contract, the beneficiary has the right to enforce this agreement.

As the *Hogan* court reasoned, "the provisions of the Trust represent a contract between [the settlor] and the trustee. However, the trust is not written for the benefit of the trustee."⁹¹ Presumably, then, the trust is written for the benefit of the beneficiaries (although the trustee does receive an agreed exchange). Thus, their interests would be paramount to those of the trustee when the question of trustee removal arises. This may be why, for example, the UTC uses the test of "best interests of . . . the beneficiaries" in both Sections 706(b)(3) and (b)(4).⁹² The question remains, however, whether the *settlor's* interests, if they conflict with the desires of the beneficiaries, control. Traditional American trust law has said yes; the English law has said no, a position we argue for, and on which the UTC is ambivalent: removal under Section 706(b)(3) does not mention the "material purpose" test, while removal under Section 706(b)(4) does.⁹³ Further ambivalence is shown in Section 65(2) of the *Restatement*, where the beneficiaries' interests are balanced against those of the settlor.⁹⁴

Another way to approach the issue of whose rights prevail is by using the relational contract lense mentioned earlier.⁹⁵ As indicated, the trustee is surely vested with considerable discretion to adjust relations with the beneficiary over time. Does the trust deal contemplate that the beneficiary has similar rights to adjust its relationship with the trustee, including the right to terminate the trusteeship? After all, Section 706(b)(4), which addresses change of

90. See UTC § 706 cmt.

91. *Hogan*, *supra* note 26, at 3.

92. UTC § 706(b)(3)-(4).

93. UTC § 706(b)(3)-(4).

94. See RESTATEMENT (THIRD) OF TRUSTS § 65(2) (Tentative Draft No. 3, 2001).

95. See *supra* notes 22, 23, and accompanying text.

circumstances over the period of the trust relationship, gives the beneficiaries this right, although it qualifies the right substantially.⁹⁶

Certainly, the American law of trust modification and termination is beginning to give beneficiaries more rights in the trustee removal area.⁹⁷ The settlor's trust deal contemplates a continuing relationship between trustee and beneficiary. Whether it also contemplates giving the beneficiaries the ultimate right of adjustment of relations—the right to terminate that relationship (as opposed to modifying it by changing other parts of the trust deal)—causes us to ask whose rights the settlor ultimately was trying to protect.⁹⁸

Although the effect of American rules making trustee removal difficult and expensive for the beneficiary may seem to favor trustees, on its face neither American nor English trust law supposes that the interests of trustees trump those of beneficiaries. As a theoretical matter, English law straightforwardly favors the interests of the beneficiaries;⁹⁹ American law does so, as well, but only if these interests comport with those of the settlor.¹⁰⁰ It seems to us that elimination of *Clafin*-like barriers to trustee removal in American law would clarify that the beneficiaries of an irrevocable trust have rights paramount to those of the corporate trustee. The right to remove a trustee for cause short of a breach of trust should be one of those rights; it also can be seen as the ultimate adjustment in a relational contract formed for the benefit of the beneficiaries and ongoing between those beneficiaries and the trustee.

C. Is the Emerging European Law of "Trusts" Helpful?

Under the common law trust, the trustee and the beneficiary share ownership of the assets; ownership is divided with the trustee having legal title and the beneficiaries having equitable title to the trust property.¹⁰¹ This form of

96. UTC § 706(b)(4).

97. See generally Ronald Chester, *Modification and Termination of Trusts in the 21st Century: The Uniform Trust Code Leads a Quiet Revolution*, 35 REAL PROP. PROB. & TR. J. 697 (2001).

98. See *supra* notes 22-23 and accompanying text.

99. See *supra* notes 69-71 and accompanying text.

100. See *supra* notes 36, 42, and accompanying text.

101. See Austin W. Scott, *The Importance of the Trust*, 39 U. COLO. L. REV. 177-79 (1967); see also *Chem. Bank N.Y. Trust Co. v. Steamship Westhampton*, 358 F.2d 574 (4th Cir. 1965). In *Steamship*, the court stated:

Scholars have long debated whether the beneficiary of a trust has a property interest in the trust *res* or merely a personal right against the trustee. The courts have had less trouble with this question. The Supreme Court has held that beneficiaries of a trust have an interest in the property to which the trustee holds legal title.

divided ownership is not recognized in civil law jurisdictions. Instead, there exists a unitary concept of ownership.¹⁰²

Civil law jurisdictions treat the beneficiaries' rights as *in personam* against the trustee.¹⁰³ A right *in personam* is a personal right to enforce the "contract" between the settlor and the trustee, which was created for the benefit of the beneficiary (the intended third party).¹⁰⁴ Common law trusts, however, create both *in personam* and *in rem* rights in the beneficiaries. The right *in rem* (a right against the trust *res* itself) prevails against personal creditors of the trustee.¹⁰⁵

Steamship, 358 F.2d at 584; *see also* *Senior v. Braden*, 295 U.S. 422, 432-33 (1935) (reaffirming the doctrine of *Brown v. Fletcher*); *Brown v. Fletcher*, 235 U.S. 589, 597, 599 (1915). In *Brown v. Fletcher*, the Court noted that modern cases did not treat the relation between trustee and *cestui que trust* as contractual; the rights of the beneficiary are determined not by an agreement between him and the trustee, but upon the terms of the trust and the duty which the law imposed upon the trustee because of his fiduciary position. As such, "a proceeding by the beneficiary . . . for the enforcement of rights in and to the property, held—not in opposition to but—for the benefit of the beneficiary, could not be treated as a suit on a contract . . . , or as a suit on a chose in action." *Brown*, 235 U.S. at 598-99. Therefore, the Court held, a beneficiary has:

more than a bare right and much more than a chose in action. [Where a beneficiary has] an admitted and recognizable fixed right to the present enjoyment of the estate . . . [h]is estate in the property thus in the possession of the Trustee, for his benefit . . . , was alienable to the same extent as though in his own possession.

Id. at 599. *But see In re George Trust*, 986 P.2d 427 (Mont. 1999). In that case, the court asserted a contrary view:

[T]he trustee has the entire or complete interest and estate in the trust property. Thus . . . the beneficiaries of an express trust in real property do not have either a legal or an equitable estate or interest in the trust property; they may only enforce the performance of the trust.

Id. at 431.

102. *See* Borrás & Beilfuss, *supra* note 15, at 159; Gretton, *supra* note 74, at 600; S.C.J.J. Kortmann & H.L.E. Verhagen, *National Report for the Netherlands*, in *PRINCIPLES OF EUROPEAN TRUST LAW*, *supra* note 15, at 195; Kötz, *supra* note 15, at 85; Reid, *supra* note 28, at 428; K.G.C. Reid, *National Report for Scotland*, in *PRINCIPLES OF EUROPEAN TRUST LAW*, *supra* note 15, at 67; Ph. Remy, *National Report for France*, in *PRINCIPLES OF EUROPEAN TRUST LAW*, *supra* note 15, at 131; R.K. Seldthusen, *National Report for Denmark*, in *PRINCIPLES OF EUROPEAN TRUST LAW*, *supra* note 15, at 174, 176; A.E. von Overbeck, *National Report for Switzerland*, in *PRINCIPLES OF EUROPEAN TRUST LAW*, *supra* note 15, at 106.

103. *See* Verhagen, *supra* note 15, at 487-88; *see also* Reid, *supra* note 28, at 431.

104. *See* Langbein, *Contractarian*, *supra* note 16, at 646 (discussing *Lawrence v. Fox*, 20 N.Y. 268 (1859)).

105. *See* Gretton, *supra* note 74, at 604-08; *see also* *PRINCIPLES OF EUROPEAN TRUST LAW*, *supra* note 15, at 70.

In addressing the trustee removal problem, the first thing that must be understood is that, despite recent reform attempts,¹⁰⁶ the basic European civil law approach to the trust is obligatory.¹⁰⁷ Thus, the promisor (trustee) is subject only to a form of personal obligation to the beneficiary, and since the trust “patrimony” (or fund) is generally not separate from the trustee’s own, the trustee’s obligation to the beneficiary is not seen as superior to his obligations to his personal creditors.¹⁰⁸ Certain other consequences of this personal contractual obligation exist. For example, duration of the “trust” is difficult to achieve on the basis of contract: “factors which would cause the termination of contracts such as the death of . . . the trustee, or breach of contract by the trustee, should not be able to cause the termination of the trust.”¹⁰⁹ Where trustees need to be replaced, the current civil law contract approach provides no help; in those cases, there is “no contractual nexus between settlor and [subsequent] trustees, so that the source of the trust obligations cannot be contract.”¹¹⁰

Since under traditional European civil law the obligations of the trustee/promisor died with her or upon her replacement, there was no way to keep the trust going. The “trustee” did not possess an office that would continue beyond his or her participation, nor was the trust in any sense a separate entity. So the traditional civil law approach of pure obligation only carries us so far in our analysis of problems in the modern Anglo-American trust.

106. In 1996, the International Working Group on European Trust Law was created, which drafted the *Principles of European Trust Law*. The main objective of the *Principles* was to introduce the trust to the civil law jurisdictions. See PRINCIPLES OF EUROPEAN TRUST LAW, *supra* note 15, at 3.

107. See Verhagen, *supra* note 15, at 487, 495. The relationship between the trustee and the beneficiary is obligatory in character. See Kortmann & Verhagen, *supra* note 102, at 196. Verhagen argued that the source of this obligation could be contractual, with the underlying basis of the trust being a contract between the settlor and trustee for the benefit of a third party (the beneficiary). See Verhagen, *supra* note 15, at 495. This *stipulatio alteri* (contract for the benefit of another), see OXFORD LATIN DICTIONARY 1822, 107 (1983), could create rights for beneficiaries other than the settlor. See Verhagen, *supra* note 15, at 495. As Verhagen points out, this is the same approach taken by the German *treuhand*, where beneficiaries other than the settlor derive their rights from a contract made for their benefit. See Verhagen, *supra* note 15, at 495.

In comparing Scot law, which follows the dual patrimony system, Verhagen argues that there is no contractual nexus between the settlor and the trustee because events that normally would cause a contract to terminate, such as the death of one of the parties (settlor or trustee), or a breach of contract, should not terminate a trust. See Verhagen, *supra* note 15, at 495.

108. See *supra* note 73 and accompanying text.

109. Verhagen, *supra* note 15, at 495.

110. Verhagen, *supra* note 15, at 495.

However, as Professor Verhagen of the Netherlands has noted, his country could emulate the Scottish “mixed” system by taking the trust outside the limits of purely contractual obligations and by separating the trustee’s personal patrimony from the patrimony constituting the trust fund.¹¹¹ He then asks:

Do we need all this in the Netherlands? . . . If we would simply provide in our civil code that in the case of *fiducia cum amico* [simple civil law trust] the assets constitute a separate fund, that would already be a major step forward, in my view even by far the most important step. We could attach some “bells and whistles” to the *fiducia cum amico* [which is now purely contractual] by providing that where a new trustee is appointed the trust fund automatically passes to the new trustee [which is not now the case and] . . . by limiting the grounds for termination of the contract with the trustee. Alternatively, we could follow the Scottish example and design a really detached trust fund [separate patrimony], a quasi-juristic person, which can survive even without any persons at all.¹¹²

Clearly, this last possibility would leave the current contractual conceptual apparatus behind.¹¹³ As Verhagen states, “we would have to accept that temporarily the trust assets could be ownerless . . . the Quebec experience demonstrates that it is possible to accommodate an ‘ownerless’ fund in a civilian system.”¹¹⁴ As to replacement of a trustee, “[s]ince no special provisions [currently exist in the civil code] in relation to the replacement of a contractual party, statutory provisions might be desirable for some particular uses of the trust.”¹¹⁵ For example, “one could contemplate provisions making regulations similar to those currently existing for the replacement of managing directors of companies.”¹¹⁶

Thus, Verhagen sees the possibility of modifying by statute the current contractual framework that his and similar jurisdictions follow, without admitting that what traditionally has been a personal right of the “beneficiary” against “trustee” has to be converted to a “real right” or even that the civil law trust has to lose its essentially contractual character. Seen in common law terms then, he envisions no problem in statutorily implying certain terms in the trust

111. See Verhagen, *supra* note 15, at 493, 495.

112. Verhagen, *supra* note 15, at 495.

113. As, for the most part, do the new *Principles of European Trust Law*, promulgated in 1999. PRINCIPLES OF EUROPEAN TRUST LAW, *supra* note 15.

114. Verhagen, *supra* note 15, at 496.

115. Verhagen, *supra* note 15, at 496.

116. Verhagen, *supra* note 15, at 496.

deal, such as continuation of the trust beyond the death or removal of a particular trustee, or, more pertinently, implying certain terms in the "contract," such as the *Hogan* court did in allowing trustee removal and replacement where this did not contravene a material purpose of the settlor.¹¹⁷

In the 1990s, the French made a concerted effort to develop their own concept of the trust through a bill that would have amended their civil code.¹¹⁸ In France, the Anglo-American trust is unknown for two basic reasons: (1) French law does not allow for the segregation of assets for specified purposes; thus, it does not allow for a separate fund that remains inaccessible to a trustee's creditors; and (2) civil law does not recognize consecutive beneficial interests in property or a distinction between legal title and equitable title in the same property in a way that is essential for the establishment of a trust.¹¹⁹ These reasons present considerable obstacles to the development of the trust concept in France.¹²⁰

Nevertheless, the international nature of business and of private assets has involved French lawyers in the use of trusts.¹²¹ Many French companies have

117. See *Hogan*, *supra* note 26, at 3.

118. See generally 2583-Feb. 20, 1992, ASS. NAT. Feb. 25, 1992.

The object of the contract is a transfer of assets and rights, accompanied by a statement in the contract setting out the terms of the management or administration to which that property is to be subjected. The transferred property will form a "separate patrimony," distinct from the personal patrimony of the fiduciary. The property will not be able to be seized either by the creditors of the constituent or by those of the fiduciary in his personal capacity. The property so held by the fiduciary as fiduciary is a "*patrimoine d'affectation*." Such a concept is the essential innovation of this new contract, a contract which can be used to accomplish as wide a variety of purposes, roughly divisible into three types, as asset management, security for loans and gifts.

Translation of Mme. Edith Cresson's written remarks to the *Assemblée Nationale* on the *Project de Loi: instituant la fiducie*. 2583-Feb. 20, 1992, ASS. NAT. Feb. 25, 1992.

119. See Remy, *supra* note 102, at 131.

120. France is not alone in its resistance to adopting the common law trust concept. Spain does not even recognize the trust concept, nor is there any intention by the Spanish legislature to introduce a trust-like institution into Spanish law. See Borrás & Beilfuss, *supra* note 15, at 159.

121. It also has involved other civil law jurisdictions, such as Switzerland. Prior to a recent change in the Swiss Banking Law permitting bank trust agreements, there was no institution under Swiss law that could meet the conditions of the trust. See Overbeck, *supra* note 102, at 105. Practitioners in Switzerland frequently deal with foreign trusts and, as a result, foreign trusts are recognized. See Overbeck, *supra* note 102, at 105. Like many of the civil law jurisdictions, Swiss law uses various institutions to fulfill the needs and purposes of the common law trust, such as the foundation (similar to the American charitable trust) and the *fiducia cum amico*. See Overbeck, *supra* note 102, at 105. Published by University of Missouri School of Law Scholarship Repository, 2002

utilized the trust as a vehicle for conducting transactions in countries where trusts exist, such as England and the United States.¹²² In order to address the discrepancy between the Anglo-American trust and European substitutes, the French government introduced a bill that would create the equivalent of the common law trust.¹²³

Under this bill, *la fiducie* (the trust) was expected to have various applications in France, including the transfer of company or other assets. The beneficiary could be a charitable organization, the employees of a company, the transferor's heirs, or any other third party.¹²⁴ Where *la fiducie* departs from the

107-08. The Swiss *fiducia cum amico* may be used either for security (*fiducia cum creditore*), or for purposes of administration and distribution of assets. See Overbeck, *supra* note 102, at 107-08. "The Swiss *fiducie* derives from the rules on mandate. The *fiduciant* [beneficiary] can give the fiduciary any instructions at any time, while normally the settlor cannot interfere with the management or disposition of the trustee." See Overbeck, *supra* note 102, at 110. Generally, a mandate can be revoked at any time. See Overbeck, *supra* note 102, at 110; Code of Obligations, CO Art. 404. The trustee (*fiduciaire*) has full ownership of the trust property. See Overbeck, *supra* note 102, at 110. On the death, incapacity, or bankruptcy of the trustee, the fiduciary agreement ends, unless the parties agree for it to continue. See Overbeck, *supra* note 102, at 110. In that case, the "trust" assets become part of the trustee's estate, and his heirs will be bound by his obligations under the fiduciary agreement. See Overbeck, *supra* note 102, at 110.

122. Although France has signed the Hague Convention on the acknowledgment of foreign trusts, it has not yet ratified it. See Frederic Mascre, *France: La Fiducie*, in INTERNATIONAL TRUST LAWS A10-3 (John Glasson ed., 1992).

The 1984 Hague Convention was designed to introduce trust law to the non-trust civil law jurisdictions. See 2 HAGUE CONFERENCE, *supra* note 30, at 361.

123. See Mascre, *supra* note 122, at A10-3. The 1992 French bill (*projet de loi*), "Concerning Fiduciaries," was introduced to add Title 16 to Book III of the French Civil Code. See generally 2583-Feb. 20, 1992, ASS. NAT. Feb. 25, 1992. It addressed the trust (*la fiducie*) and, for the first time in French law, allowed for a separation of assets for the purpose of a trust. In addition, the bill alluded to the utility of a conceptual division of ownership. See 2583-Feb. 20, 1992, ASS. NAT. Feb. 25, 1992. The bill was preceded by an *avant-projet*, introduced by the Ministry of Justice in 1990, and, in May 1991, the Finance Ministry published comments on the *avant-projet* from a tax perspective. See 2583-Feb. 20, 1992, ASS. NAT. Feb. 25, 1992; see also Mascre, *supra* note 122, at A10-3. The bill itself was introduced on February 20, 1992, in the *Assemblée Nationale*, and proposed nine new articles to be introduced into the Code Civil, forming a new chapter entitled "*de la fiducie*." See generally 2583-Feb. 20, 1992, ASS. NAT. Feb. 25, 1992. The bill could be viewed as an attempt to compete economically in the global marketplace and had a large degree of support from bankers, businessmen, lawyers, and scholars.

124. See generally 2583-Feb. 20, 1992, ASS. NAT. Feb. 25, 1992, I § 3-5 (*L'objet du contrat: Protection des créanciers; Protection des héritiers réservataires, etc.*).

standard law of contracts¹²⁵ is indicated in Article 2070-1 of the bill, which addresses the beneficiaries' right under certain circumstances to remove and replace the trustee by order of the court.¹²⁶ By implication from this Section, *la fiducie* is not simply a contract between two parties for the benefit of another, but, rather, it exhibits the potential to be viewed as an entity unto itself, however limited in power. This concept exhibits a degree of sophistication about trusts and makes strides toward emulating the Anglo-American trust. However, under the bill, the beneficiary is only able to remove the trustee in extreme cases, such as abuse of the position or the placing of the beneficiaries' interests in danger.¹²⁷

There are two forms of ownership of trust assets under the bill. Because the basis of *la fiducie* is fundamentally contractual, the settlor is able to determine the terms of the trust in the contract.¹²⁸ This contract can be made between the settlor and the trustee for the benefit of the beneficiary (similar to the traditional third party beneficiary contract). The contract also can be made between the settlor and the beneficiary directly, creating a set of duties imposed upon the trustee until the completion of the trust.¹²⁹

125. Article 2062 of the bill defines *fiducie* as:

a contract by which a person [*constituant* or "settlor"] transfers all or part of his property rights to a fiduciary [*fiduciaire* or "trustee"] who, holding this property and these rights separate from his own personal assets [*patrimoine*], deals with the said property and rights for the benefit of one or more beneficiaries as provided in the terms of the contract.

2583-Feb. 20, 1992, ASS. NAT. Feb. 25, 1992, 16 Art. 2062. Thus, even the reform bill saw the trust as essentially contractual.

126. Article 2070-1 states:

The fiduciary performs his duties in the respect of the confidence of the settlor. If the fiduciary seriously defaults in his duties or puts in peril the interests which are entrusted to him, the settlor or the beneficiary can require in justice the appointment of a provisional administrator or the replacement of the fiduciary. They can also ask for the termination of the trust. The court order making the right carries out the request that the fiduciary shall be automatically relieved of his duties as administrator.

2583-Feb. 20, 1992, ASS. NAT. Feb. 25, 1992, 16 Art. 2070-1.

127. See 2583-Feb. 20, 1992, ASS. NAT. Feb. 25, 1992, 16 Art. 2070-1.

128. The settlor is unable to enter a contract with himself (*i.e.*, no self-settled trusts), and all of the elements of the *fiducie* rest upon the basis of a bilateral agreement. See 2583-Feb. 20, 1992, ASS. NAT. Feb. 25, 1992, 16 art. 2062, 2070-1.

129. Thus, if the beneficiary is in the position of a third party beneficiary as per a contractual provision (*stipulation pour autrui*) between the settlor and the trustee, he acquires a direct *in personam* right against the trustee. "Under the bill, this right entitles him to not only demand performance of the *fiduciaire* (trustee) in his favour, but also to apply to have the *fiduciaire* replaced or the *fiducie* (trust) terminated in the event of a material breach by the *fiduciaire*." Had it been enacted, this latter provision would have moved French law on trustee removal in the direction of traditional Anglo-American law

The bill was ultimately withdrawn in 1995 by the Ministry and, with the exception of a brief reference in Senator Philippe Marini's¹³⁰ report on economic modernization in 1996, it has not reappeared.¹³¹ Although there are currently no plans to reintroduce the concept of *la fiducie*, it has generated a degree of interest that may stimulate the French to address the concept in the future. Probably *la fiducie* will have to resurface, in one form or another, if France is to remain a formidable contender in international business affairs. In any case, the French, like the Dutch, already have considered building on their contractual understanding of the nature of the trust, or even (as seen in certain aspects of the French bill) moving beyond it.¹³²

on the subject. 2583-Feb. 20, 1992, ASS. NAT. Feb. 25, 1992, I § 3-5.

If, however, under the bill, the contract is established between the settlor and the beneficiary directly (a circumstance in which the trustee would be viewed as having "ownership with duties" as opposed to "ownership of the assets"), the beneficiary would have a right to the assets *in rem* because he would be considered the true owner of the assets. This section of the bill represented a true departure from basic contractual frameworks. 2583-Feb. 20, 1992, ASS. NAT. Feb. 25, 1992, I § 3-5.

130. Senator Marini serves on the *Commission des Finances* of, and is *Rapporteur General* for, the French Senate. That body is elected by indirect suffrage, unlike the other House of Parliament, the General Assembly. Each senator is elected for a term of nine years; one-third of the Senate's membership is renewed every three years. The Senate has no veto power over legislation since it can be overruled by the General Assembly on a bill's second hearing. See *France Law Digest*, MARTINDALE-HUBBELL INTERNATIONAL LAW DIGEST, at A1 (2001).

131. A major reason for its ultimate failure was that "the fiscal authorities were unable to be assured that this new *fiducie* would not cause significant tax avoidance in [France], and therefore withdrew their support." D.W.M. Waters, *Institution of the Trust in Civil and Common Law*, in RECUEIL DES COURS DE L'ACADEMIE DE DROIT EUROPEEN 396 (1995).

132. The *bewind* is the Dutch instrument that can be compared to the trust. See Verhagen, *supra* note 15, at 477 n.1. However, unlike the trustee of a common law trust, the administrator of the *bewind* (*bewindvoerder*) does not own the assets placed under the *bewind*. See Verhagen, *supra* note 15, at 477 n.1. The assets are owned by the beneficiaries; the administrator having only exclusive power to deal with those assets. See Verhagen, *supra* note 15, at 477 n.1.; see also Reid, *supra* note 28, at 430. Because the assets to be managed are not legally owned by the *bewindvoerder*, the assets remain unaffected by the bankruptcy of the *bewindvoerder* and, in this respect, offers the beneficiary some protection from insolvency of the *bewindvoerder*. See Kortmann & Verhagen, *supra* note 102, at 199.

*D. Understanding the Trustee Removal Problem
and Its Possible Solution*

Advanced thinking about trusts in the European civil law system recognizes that the Europeans' traditional obligational approach to the trust goes only so far: a modern trust in the Anglo-American sense may have contractual features, but is, at the same time, more than a contract. European experts now seem willing to engraft common law features onto the obligational skeleton without excessive worry about doctrinal purity. Thus, the rights of the beneficiary can be more than personal rights to the trust property (in fact, it can give the beneficiary a preference over the trustee's other creditors) but not necessarily constitute a real right; separate patrimonies can solve the problem that civil law does not recognize equitable title; and the trust itself can survive its contractual participants. The lesson for our present inquiry is that a purely doctrinal focus, such as whether trusts are contract-based or property-based, can illuminate a problem but does not necessarily provide final solutions.

With this understanding, we return to the problem of the beneficiaries' ability to change corporate trustees when they are dissatisfied. We believe it helps in the analysis of this issue to understand the modern trust deal. To reiterate, the settlor contracts with a bank, which agrees to manage and administer her assets for the benefit of her chosen beneficiaries under designated and implied (or "default") contractual terms; in return, the bank receives a fee. If the settlor is alive, but the trust is irrevocable, the UTC instructs us that, incident to that contract, the settlor retains an interest in the question of trustee removal.¹³³

If the contract comes into being only at the settlor's death (because contained, for example, in a will), certain features of the trust deal immediately become apparent. First of all, the settlor no longer has rights as a contracting party: her death cuts off rights to the continuing performance of what may be viewed as a service contract.¹³⁴ While American trust law may continue to honor her intent because of the *Clafin* doctrine, this is not something the settlor generally contracts for expressly. It can be understood as an implicit feature of American trust law.

Despite the death of the settlor, contractual rights survive. These are vested in the beneficiary, who stands, in contractual terms, in the position of third party beneficiary. Do these rights include the rights of easy trustee removal?

The trust deal was created for the third party's benefit. On the other hand, the settlor wished to place limitations on the beneficiary's rights: otherwise, she would have granted the property in fee. Clearly, the distributive provisions that

133. UTC § 706.

134. See, e.g., *Farnon v. Cole*, 259 Cal. App. 2d 855 (Dep't Super. Ct. 1968).

limit beneficiary rights survive the settlor, unless the beneficiaries have the power to terminate the trust and establish a new one, which is problematical under American law. But, as the *Hogan* court found, one corporate trustee can perform the same administrative functions as another. Because the trust deal is primarily for the beneficiaries' benefit, they must have the right to have the trust's distributive provisions administered for them in an efficient and cost-effective manner. Presumably, the settlor would have intended this: in American trust law terms, it would not have served a material purpose of the settlor for her initial selection of a trustee to be maintained if the trustee was not administering the trust in the beneficiaries' best interests.

We might argue that the beneficiaries' best interests, under such a trust deal, should trump the settlor's selection of an initial trustee. Even in the relatively rare case in which this selection was a material purpose of the trust, acceptance of the *Hogan* standard allowing such settlor control would nonetheless constitute progress. Even more progress could be made if the law were to establish a *presumption* that switching corporate trustees violates no material purpose of a settlor.

So, from the contractual perspective, it can be argued that the trust deal the settlor makes with a corporate trustee carries an implied term that the fiduciary shall administer the trust in the best interests of the beneficiaries. If the beneficiaries want to replace such a trustee, they certainly should be able to do so if this contravenes no material purpose of the settlor (as is likely in the case of replacement of one corporate trustee with another). Further, we would argue either that there is a presumption, in such circumstances, that no material purpose is contravened or, even better, that the material purpose test be ignored. Section 706(b)(3) of the UTC follows this latter approach when it allows the court to remove the trustee for "unwillingness, or persistent failure of the trustee to administer the trust effectively" without regard to any material purpose of the trust.¹³⁵

Of course, UTC Section 706(b)(3) sets the bar rather high in its requirements of: (a) "persistent failure" by the trustee; and (b) removal by a court. If all beneficiaries simply could join together, remove a corporate trustee, and replace it with another whenever they felt it was in their best interests to do so, beneficiaries would be given maximum flexibility in "playing" the corporate trustee market. The easy portability ultimately sought by HEIRS® would be achieved.

Still, one hesitates to go this far. The settlor's contract with the corporate trustee for the benefit of the beneficiary only arises because some benefit to the trustee (in the form of fees) has induced the trustee to enter this arrangement. If the beneficiaries are given *carte blanche*, is the trustee's expectation of fees over

135. UTC § 706(b)(3).

a period of time impaired?¹³⁶ Is the settlor making an illusory promise to the trustee/promisor? In part because the trustee must be given at least some expectation of a continuing (fee-generating) relationship with the trust, it would seem that the beneficiaries' right cannot be unlimited.

The deal, then, should carry the "best interests of the beneficiaries" term, but this is a standard whose fulfillment should be determined by a third party in the form of the court. Further, the "best interests" standard should be applied objectively; the settlor, in making the contract for beneficiaries' benefit, would not have intended to give them a degree of control that could be exercised on a whim. Otherwise, why not skip the trust deal entirely and transfer to the beneficiaries a fee simple?

Obviously, neither the requirement of court approval nor an objective interpretation of "best interests" helps achieve maximum portability. On the other hand, if corporate trustees know that they can be replaced under a standard such as is advanced in UTC Section 706(b)(3) or, perhaps better, one requiring simply a pattern of failure (rather than persistent failure) to administer the trust effectively, they probably will become more compliant with beneficiary requests. This compliance may manifest itself both in the trustee's greater attention to beneficiary complaints and, failing that, in a greater willingness to "step aside" voluntarily upon the beneficiaries' demand. In addition, it can be improved if the use of trust assets by the trustee in defense of a removal action is further limited by law.¹³⁷

IV. CONCLUSION

Ultimately we would argue that some balance needs to be struck between easy portability of a given corporate trusteeship and the interests of settlor/promisee and trustee/promisor in establishing the trust deal. To argue that the right established in the beneficiary implicitly contains the right to removal on demand simply flies in the face of reason and ignores the probable intentions of both promisee/settlor and promisor/trustee.

136. See Langbein, *Contractarian*, *supra* note 16, at 653-54; see also *supra* notes 22, 23, 95-98, and accompanying text.

137. Currently, "reimbursement [of the trustee] . . . may include attorney's fees and expenses incurred by the trustee in defending an action." UTC § 709 cmt. An exception to reimbursement occurs if the trustee is found to be in breach of trust. See 3A AUSTIN W. SCOTT & WILLIAM F. FRATCHER, *THE LAW OF TRUSTS* § 245 (4th ed. 1988). However, the Comment to UTC Section 1004 notes that, as Section 709 states, reimbursement is limited to expenditures "properly incurred in the administration of the trust." UTC § 709(1). Also, the comment to UTC Section 1004 notes that a beneficiary may be awarded litigation costs if the litigation is deemed beneficial to the trust. See UTC § 1004 cmt.

Despite its contractual nature, the trust deal, as modern civilian lawyers have seen, contains principles foreign to simple contract: ordinarily, the settlor intends the trust to survive the death of an individual trustee or the removal of a corporate one. This means that replacement of trustees and continuation of the trust, even if not expressly stated, are generally contemplated in the original trust deal, whether or not this deal is seen as having elements of a relational contract.¹³⁸ Moreover, it does not mean that replacement should be overly difficult. Trust beneficiaries were originally given a right that at least includes effective trust administration. They should be able to exercise it in unison, or, even if there is disagreement among them, when a court determines it is in their best interests to do so; this is a standard that should not be restrictively applied. Perhaps the standard that would work best would be a modified Section 706(b)(3), allowing removal by the court because of a pattern of (rather than persistent) failure by the trustee to administer the trust effectively. This is a term in the trust deal that most settlors contemplate when they make one, whether the trust says so expressly or not.

In its examination of the trust deal on removal, the UTC appears to go beyond the existing law of trustee removal in Section 706(b)(3) by focusing on the rights of beneficiaries without regard to the “material purpose” test. In contrast, the *Restatement* relies on its Reporter’s Notes to deal with trustee removal, emphasizing that removal is a form of modification, and using *Hogan* to illustrate progress on the removal issue, despite its use of the *Clafin* standard.¹³⁹

Moreover, we believe that the substance of UTC Section 706(b)(3) moves beyond the law as stated in the Reporter’s Notes to the *Restatement (Third) of Trusts* Section 65. It should be recalled that *Hogan* (cited in those Notes), although holding that a change in corporate trustees did not offend the “material purpose” test in the circumstances, still used the test. By contrast, Section 706(b)(3) eliminates the test entirely. In contractual terms, this subsection seems to be assuming that removal on grounds such as “unwillingness or persistent failure . . . to administer the trust effectively”¹⁴⁰ would be a right the settlor intended his beneficiaries to have. Thus, no separate “material purpose” test needed to be included.

For removal on the more general grounds of substantial changed circumstances (or on unanimous agreement of the qualified beneficiaries) under Section 706(b)(4), however, the UTC drafters included the “material purpose” test. Perhaps this is because there are no separately stated grounds for removal

138. See *supra* notes 22, 23, 95-98, 136, and accompanying text.

139. See RESTATEMENT (THIRD) OF TRUSTS § 65 cmt. f (Tentative Draft No. 3, 2001).

140. UTC § 706(b)(3).

in this provision that the drafters could assume would be part of the typical trust deal,¹⁴¹ and they wanted to include the test as a check on precipitous beneficiary action. The “material purpose” test is also included where unanimity of the beneficiaries, with or without changed circumstances, allows removal.¹⁴²

It seems sensible for the drafters of Section 706(b)(4) to have assumed that the trust deal would not have included the right of beneficiaries to remove a trustee *just* because they all agreed, if such an agreement violated a material purpose of the trust; at the same time, “substantial changed circumstances” should be enough of a check on the beneficiaries that the “material purpose” test is unnecessary as an adjunct to that ground. However, since the drafters in fact did retain the “material purpose” test when “changed circumstances” is the ground for removal, we place greater hope for reform of trustee removal law on Section 706(b)(3), particularly if its “unwillingness” provision is used or its “persistent failure” standard is changed to “a pattern of failure” or the like. Alternatively, courts might use a modified *Hogan* approach, establishing either a rule or presumption that a change of corporate trustees does not violate a material purpose of the settlor. This approach can be used under either Section 706(b)(4) or *Restatement (Third) of Trusts* Section 65(2).

In any event, both the UTC and *Restatement (Third) of Trusts* loosen *Clafin*'s hold on trustee removal and allow somewhat freer portability.¹⁴³ We hope that using the contractual lense suggested by civil law has helped the reader understand why this practically sound approach also makes sense theoretically.

141. The Comment, as opposed to the text, gives examples of what might or might not be a change of circumstances: “a corporate reorganization of an institutional trustee is not itself a change of circumstances if it does not affect the service provided the individual trust account.” However, removal could be triggered by a “substantial change in the character of the service or location of the trustee.” UTC § 706 cmt.

142. UTC § 706 cmt.

143. *See supra* notes 10-13, 51-62, and accompanying text.

