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A BRIEF COMMENT ON TRUST PROTECTORS

Jeffrey Evans Stake*

In Trust Protectors, Agency Costs, and Fiduciary Duty, Professor Stewart Sterk has provided a valuable and insightful exposition of many of the issues arising from the recent importation of trust protectors from offshore asset protection trusts into domestic trusts. Naturally, there are many other questions that he could not address. This Comment adds one point to Professor Sterk’s extensive discussion. Much of his analysis applies the agency cost approach suggested by Professor Robert Sitkoff in his seminal article, An Agency Costs Theory of Trust Law, and in so doing focuses on many considerations that should be important to settlors of domestic trusts. There is another level of consideration that also deserves attention, that of the common good. What are the social welfare costs and benefits of adding trust protectors to the toolkit available to settlors or testators?

This Comment divides the analysis into two strands, with the criterion of division being the purpose of the trust protector. A trust protector can be employed for the benefit of beneficiaries or solely for the purpose of protecting the wishes and designs of the settlor. The first part of this Comment addresses those situations in which the trust protector is employed, at least in substantial part, for the benefit of the trust beneficiaries. The second part discusses some of the consequences that flow when the protector is employed to further the intention of the settlor separate and apart from the interests of the beneficiaries. This Comment ends with a tentative recommendation for law reform.

* Professor of Law, Indiana University School of Law-Bloomington. The ideas expressed here were stimulated by the excellent conference, Trust Law in the 21st Century, hosted by the Benjamin N. Cardozo School of Law, September 19, 2005. I thank Christopher S. Stake for helpful comments.


3 Although much of the analysis applies equally to whether the trust is created inter vivos or in a will, this Comment will refer only to settlors.
I. FOR THE BENEFIT OF THE BENEFICIARIES

Notwithstanding possible counterproductive effects catalogued by Professor Sterk,\(^4\) it is likely that some trust protectors whose powers are designed to protect the interests of beneficiaries will indeed improve the management of their trusts. Moreover, that is ordinarily a call for the settlor to make. When the terms of the trust instrument make it clear that the function of the trust protector is to protect the interests of the beneficiaries, it is reasonable to presume that the settlor is correct in her judgment that the beneficiaries will be better off because of the presence of the protector.

Indeed, it is possible to imagine a number of roles the protector might play, any one of which could improve benefits to beneficiaries and, at the same time, improve social welfare. The predominant model of the trust incorporating a protector appears to be a private, hierarchical structure. The trust protector plays a role somewhat like the board of directors of a corporation,\(^5\) overseeing the performance of the management on behalf of the shareholders, or in this case, the trust beneficiaries. But other models might be used to invent protectors of the interests of the beneficiaries. One such model might be taken from constitutional law rather than corporate law. The role of the trustee carrying out the instructions of the settlor with money supplied by the settlor for the benefit of the beneficiaries can be seen as analogous to the role of the executive carrying out the instructions of the legislature with money supplied by the legislature for the benefit of the public.

This analogy suggests roles for the trust protector different from that of trustee overseer. A settlor might wish to cast the trust protector in the judicial role of hearing and resolving disputes between the beneficiaries and the trustee. Such an administrative structure could have a number of advantages. First, the protector might better serve the interests of the beneficiaries because he knows them and their needs far better than a court does. Second, the beneficiaries might be in a better position to keep the trustee honest because they would not need to raise the money to underwrite a lawsuit or worry about the social opprobrium that may accompany recourse to a court. And, with the protector readily available for resolving suits at low cost, the trustee might feel more pressure to adhere to his best guess as to what the protector would consider to be in the interests of the beneficiaries. Finally, if the protector were substituted for the court, society would benefit from the reduced load on publicly supported tribunals. The internalization of the

\(^4\) See, e.g., Sterk, supra note 1, at 2789.

\(^5\) Id.
dispute resolution costs could be good for both the beneficiaries and the public.

One problem with having the protector take on a judicial role is that the protector’s jurisdiction could be invoked only if the beneficiaries were able to monitor and detect deviations from their interests. If they do not know enough about what the trustee’s activities are or should be, they will be unable to bring their complaint before the protector. In these situations, the beneficiaries need an advocate to watch out for them more actively. The governmental analogy might be pushed in a different direction by setting up a protector in the role of an independent prosecutor charged with protecting the beneficiaries’ interests from trustee malfeasance. In many cases, such a protector would be better able to vindicate the interests of the beneficiaries than they themselves could do. And, as above, the mere presence of the private prosecutor might cause the trustee to hew more closely to the interests of the beneficiaries. Finally, the two roles are not mutually exclusive. The settlor could establish two protectors, one as a prosecutor and another as a judge, if she preferred that to having the prosecuting protector bring his case in state courts.

II. FOR THE BENEFIT OF THE SETTLOR

It is less clear that there will be welfare benefits when the draftsman creates a protector to ensure that the trustee follows the goals of the settlor than when she designs the protector to protect the interests of the beneficiaries. Although the settlor ostensibly created the trust to benefit the beneficiaries, their interests need not be coterminous with those of the settlor. By preventing the beneficiaries from collectively terminating the trust while a material purpose of the settlor remains, the Claflin doctrine affirms that there are judicially cognizable interests of the settlor separate from those of the beneficiaries.

What then are the costs and benefits to society when the protector acts to protect the goals of the settlor as distinct from those of the beneficiaries? If the settlor is alive, there are clear gains to her. On the other side of the equation, the living settlor can also appreciate the direct costs of compensating the protector and indirect agency costs suffered if the protector unexpectedly reduces the degree to which the trustee follows the intent of the settlor. The living settlor can weigh those costs and benefits, and there is no need for second-guessing her choice.

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In many cases, however, the settlor will employ the protector to watch out for her interests after she is dead and her interests have dropped out of the social welfare equation. In some of these cases, the protector’s actions will not further the interests of the beneficiaries. What is the social gain or loss from the action of the protector? It is possible, of course, that the protector would affirmatively enjoy such a task, and would be willing to do it for no compensation whatsoever. If that is the case, the trust’s creation of the role of protector could well add to social welfare; the settlor has provided the protector some entertainment. But assume that the actual performance of the duty is not enjoyable, that the protector would not work without pay. In such cases, there is a clear difference between the trust having a protector and not having one, and it no longer favors the protector. From a societal point of view, the settlor has caused a person, presumably a person of some talent, to forego leisure and opportunities for productive behavior in favor of furthering the intent of a dead person. Thus, society is left paying the continuing and probably escalating costs of the settlor’s fancy.

This problem would be exacerbated in a perpetual private trust, which has been made possible by the abolition of the Rule Against Perpetuities in many jurisdictions.\(^7\) Suppose that the settlor settles a perpetual trust to pay someone, say someone with a professional degree, to throw rocks in the ocean for eight hours a day, chanting her name with each throw. Assuming that we will not have any social use for more rocks in the ocean or names chanted into the air, should courts—100, 1000, or 10,000 years from today—continue to honor the trust? The amounts paid by the trust for this service are mere transfer payments; they increase the wealth of the thrower while decreasing the wealth of the trust and its potential beneficiaries, for a net social gain of zero. Since the social gain from the rocks tossed and the payments made is zero, the key consideration in the social welfare calculus is the effort expended. This human labor is wasted. The rock tosser could have created valuable goods and services instead. Or, he could have used the time for leisure activities such as watching television or anything else that he might have enjoyed more than tossing rocks. The value of the goods he could have created or the leisure he could have enjoyed is the social loss from honoring the trust. The behavior of a trust protector, when there is no benefit to the beneficiaries, is like that

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\(^7\) The Rule Against Perpetuities serves at least five purposes. See Jeffrey E. Stake, Darwin, Donations, and the Illusion of Dead Hand Control, 64 TUL. L. REV. 705 (1990). The Rule (1) frees land for development by terminating options, (2) makes land more purchasable by a non-owner, (3) makes assets more enjoyable for an owner by eliminating restrictions on behavior and reducing uncertainty, (4) fairly divides between generations the enjoyment taken from the act of giving control, and (5) reallocates interests from people who cannot enjoy ownership of the interest to people who can. Id.
of the chanting rock tosser. The protector’s efforts have no utility other than that to the settlor and, as just noted, she is dead.

The usual response, of course, is that honoring her intent after she is dead, while doing nothing to increase utility at that time, makes the settlor happier while she is alive. Thus, the question is whether the happiness of knowing intent will be followed outweighs the losses of leisure and productivity. This question is not easy to answer, but there are two considerations. First, the law has chosen, at times, not to honor testamentary requests to destroy assets. There is no economic reason to suppose that the human efforts to be saved by eliminating a trust protector are any less valuable than the property saved when the instructions to destroy it are ignored. Indeed, because a trust could last forever, it might have greater potential for wasting human resources than a simple instruction to destroy some tangible personality.8

Second, not only is there large potential for waste, as measured from the point starting with the settlor’s death, there is reason to question the size of the settlor’s benefits from the protector’s efforts. Honoring the intent of settlors that create protectors after they are dead makes settlors feel better while they are alive, but how much better? The analysis at this point gets quite speculative because it is hard to put the protector genie back into the lamp. Once settlors become aware of the use of protectors, they may feel uncomfortable without one. But if they are never told about the need for protectors, i.e., if no one raises the issue of trustee misbehaviors that are beyond courts to rectify, many settlors will go to their graves perfectly content with their settlements. For them, protectors only serve to quell fears they would have never had if protectors and the need for them had not been mentioned.

Some may say that because the market works and individuals will behave rationally, there is no possibility that the increase in settlor security will not be worth the costs. Perhaps this is so, but it also seems possible that lawyers and others will, in good faith or bad,9 raise fears that would not otherwise arise. One of the benefits of legal advice is that lawyers sometimes think of possibilities that the client did not. In this context, where the protector is being employed solely to follow the

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8 It is worth noting that the efforts of a trust protector one thousand years from now should not be discounted to present value, or at least should not be discounted to present value by the rate of inflation. To be accurate, we should increase the value of labor by the rate at which professional wages will rise over the next thousand years. Then that figure, which of course will be huge, should be discounted by the rate of inflation over the same years. If wages outstrip inflation, then the result will be that an hour of labor wasted one thousand years from now will be worth more than the same hour today. Thus, it is easy to see that the dozens of hours wasted for each of the next thousand years could have a very large present value.

9 Lawyers might raise the fears of trustee misbehavior to induce clients to draft new trust instruments, thus generating more income for the lawyers. Lawyers will often think they are doing the client a favor, without asking themselves whether the client is actually any happier at the end of the day.
settlor’s intent after she is dead and not for the benefit of the beneficiaries, what is usually good legal planning may fail to yield any increase in social welfare. Empirical research that compares the security felt by those who use protectors for domestic trusts to those who are never told about them might shed some light on this issue.

III. Law Reform

On this initial analysis it matters whether the settlor created the position of trust protector to make sure she gets what she wants after she is dead or to make sure the beneficiaries are well served. Because it is hard to get inside the head of the settlor, applying this distinction will often be difficult. However, there is a set of circumstances in which it may not matter which thoughts or feelings actually motivated the settlor. When all of the beneficiaries agree that the trust protector is not serving their interests, we should presume that they are right. Therefore, when they all agree, the beneficiaries should be allowed to eliminate the compensation for the trust protector and free the trust from that drag on the trust assets. In other words, the Claflin doctrine should not be extended to protect the trust protector.\(^\text{10}\) In addition, it may be possible in the future to identify other circumstances in which the trust protector fails to benefit the beneficiaries, and perhaps the courts should be willing to eliminate the protector in those situations as well.

The remaining, and larger, question is whether anything else should be done. It would be imprudent to say trust protectors are not authorized to take any legal action or that the provisions of the trust authorizing protectors are unenforceable. It is hard to justify such a severe limitation on settlors, especially when trust protectors could be quite useful for offshore and charitable trusts. For similar reasons, an ethical rule discouraging lawyers from recommending protectors would appear unjustified. Nor should volunteers be prevented from performing their protecting assignments if they enjoy them. But whether protectors that are compensated should continue to be paid is another matter.

The normative policy analysis of trust protector law is in its infancy. As with other issues involving wills and trusts, the intent of the decedent and the costs of administration are likely to drive much of the analysis. But those are not the only concerns. The deployment of human resources deserves close attention and, in that connection, it is

\(^{10}\) Whether the Claflin doctrine itself deserves elimination is a topic too large for this Comment, but some of the same considerations would seem applicable, at least in situations where the trust is not subject to the Rule Against Perpetuities.
important to keep in mind that self-interested decisions by informed private actors will not necessarily reach an efficient allocation.