



# Trusts and Estates: Implementing Freedom of Disposition

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## TRUSTS AND ESTATES: IMPLEMENTING FREEDOM OF DISPOSITION

ROBERT H. SITKOFF\*

The Trusts and Estates course is about the law of *gratuitous transfer* at death, that is, the law of *succession*.<sup>1</sup> Lately such courses have come to cover both *probate* succession by *will* and *intestacy*, and *nonprobate* succession by inter vivos trust, pay-on-death contract, and other such *will substitutes*. The organizing principle of the American law of succession, both probate and nonprobate, is *freedom of disposition*. My suggestion in this Essay, which I have implemented in my Trusts and Estates class and in the casebook for which I am the surviving coauthor,<sup>2</sup> is that the Trusts and Estates course can likewise be organized around this principle. The Trusts and Estates course is perhaps best conceptualized as a survey of the law and policy of implementing freedom of disposition.<sup>3</sup>

### I. INTRODUCTION: FREEDOM OF DISPOSITION

The American law of succession embraces freedom of disposition, authorizing *dead hand* control, to an extent that is unique among modern legal

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1. Other common names for this course are Estates and Trusts; Wills and Trusts; and Decedent's Estates. A few years ago, at the outset of my tenure as Chair of the Executive Committee of the relevant Section within the Association of American Law Schools, we changed the Section's name from Donative Transfers, Fiduciaries and Estate Planning to Trusts and Estates. We reasoned that Trusts and Estates was less cumbersome, more intuitive, and more in accord with how most instructors self identify.

2. JESSE DUKEMINIER & ROBERT H. SITKOFF, *WILLS, TRUSTS, AND ESTATES* (9th ed. 2013).

3. My focus, therefore, is on second-order questions of design rather than the first-order question of why freedom of disposition, on which see, for example, the sources cited in *infra* note 9.

systems.<sup>4</sup> Within the American legal tradition, a property owner may exclude his or her blood relations and subject his or her dispositions to ongoing conditions, as in the classic teaching case of *Shapira v. Union National Bank*.<sup>5</sup> The right of a property owner to dispose of his or her property on terms that he or she chooses has come to be recognized as a separate stick in the bundle of rights called property.<sup>6</sup>

There are, of course, some limits on freedom of disposition. The law protects a decedent's creditors and surviving spouse, and it imposes a handful of other policy limitations, such as the Rule Against Perpetuities. Gratuitous transfer of property, whether during life or at death, is also subject to wealth transfer taxes.<sup>7</sup> For the most part, however, the American law of succession facilitates, rather than regulates, the carrying out of the decedent's intent. Most of the law of succession is concerned with enabling posthumous enforcement of the actual intent of the decedent or, failing this, giving effect to the decedent's probable intent.<sup>8</sup>

Notice the emphasis on the *donor* rather than the *donee*. The interest protected by the law of succession is the donor's right to freedom of disposition. The interest of a prospective donee, being derivative of the donor's freedom of disposition, does not harden into a cognizable legal right until the donor's death. Until then, a prospective beneficiary has a mere expectancy that is subject to defeasance at the donor's whim. Consequently, the justification for freedom of disposition must be found in the balance of the "proper rewards and socially valuable incentives to the donor"<sup>9</sup> against the risk of perpetuating inequality and concentrating economic and political power.

Along with the nature and function of freedom of disposition, it is convenient at the outset of the Trusts and Estates course to consider the

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4. See, e.g., RAY D. MADOFF, IMMORTALITY AND THE LAW: THE RISING POWER OF THE AMERICAN DEAD 6–7 (2010).

5. *Shapira v. Union Nat'l Bank*, 315 N.E.2d 825, 832 (Ohio C.P. 1974); see also Ronald J. Scalise, Jr., *Public Policy and Antisocial Testators*, 32 CARDOZO L. REV. 1315 (2011); Joshua C. Tate, *Conditional Love: Incentive Trusts and the Inflexibility Problem*, 41 REAL PROP. PROB. & TR. J. 445 (2006).

6. See *Hodel v. Irving*, 481 U.S. 704, 716 (1987); DUKEMINIER & SITKOFF, *supra* note 2, at 33.

7. Such taxes were upheld in *New York Trust Co. v. Eisner*, 256 U.S. 345, 349–50 (1921) (estate tax), and *Bromley v. McCaughn*, 280 U.S. 124, 137–38 (1929) (gift tax).

8. See RESTATEMENT (THIRD) OF PROP.: WILLS AND OTHER DONATIVE TRANSFERS § 10.1 cmts. a, c (2003).

9. Edward C. Halbach, Jr., *An Introduction to Chapters 1–4*, in DEATH, TAXES AND FAMILY PROPERTY 3, 5–6 (Edward C. Halbach, Jr. ed., 1977); see also Adam J. Hirsch & William K.S. Wang, *A Qualitative Theory of the Dead Hand*, 68 IND. L.J. 1, 5–6 (1992); Daniel B. Kelly, *Restricting Testamentary Freedom: Ex Ante Versus Ex Post Justifications*, 82 FORDHAM L. REV. 1125, 1135 (2013).

professional responsibility of lawyers in succession matters. Doing so alerts students to the ethical perils in trusts and estates practice,<sup>10</sup> and it invites consideration of the role of the trusts and estates lawyer as family counselor. Because the exercise of freedom of disposition at death is the decedent's final expressive act, the Trusts and Estates course is fundamentally about people and their most intimate relationships. Each case is a drama in human relationships and a cautionary tale.

## II. INTESTACY: AN ESTATE PLAN BY DEFAULT

A person who dies with a will is said to die *testate*. The probate property of such a person is distributed in accordance with the person's will. But at least half of the U.S. population dies without a will. Distribution of the probate property of these people, who are said to die *intestate*, is governed by the *default rules* of the law of *intestacy*. If a will disposes of only part of the probate estate, the result is a *partial intestacy* in which the probate property not disposed of by the will passes by intestacy. Intestacy is therefore the background law that supplies an estate plan by default for intestate decedents. Intestacy also influences norms of testamentary disposition and supplies constructional rules that figure in the interpretation of wills, trusts, and other will substitutes.

In accordance with the principle of freedom of disposition, the primary objective in designing an intestacy statute is to carry out the probable intent of the typical intestate decedent—that is, to provide majoritarian default rules for property succession at death. Unfortunately, this task often involves substantial guesswork, as the disparate preferences of persons without a will must be aggregated into a model intestate decedent.<sup>11</sup> Evolving social norms have made this undertaking increasingly difficult, as family and family-like relationships have become more varied and complex. Multiple marriages, same-sex marriages, blended families, adoption, and unmarried cohabitation have become increasingly common. Medical science now offers the making of a baby without coitus. The egg, sperm, and womb needed to make a baby can be provided by three different persons, the first two even after the person has died, and the intention of all involved might be for still other persons to function as

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10. A study by the American Bar Association found that between 2008 and 2011 a bit more than ten percent of all ethics complaints involved a trusts and estates matter. *See* AM. BAR ASS'N, PROFILE OF LEGAL MALPRACTICE CLAIMS 2008–2011 5 (2012).

11. *See, e.g.*, Alyssa A. DiRusso, *Testacy and Intestacy: The Dynamics of Wills and Demographic Status*, 23 QUINNIPIAC PROB. L.J. 36, 56 (2009).

the parents of the baby. Discerning who is a child of whom for inheritance purposes has become complex.<sup>12</sup>

In light of evolving family and family-like relationships, to track the probable intent of the typical intestate decedent, the law of intestacy must likewise evolve. But on some issues, there is no clear majoritarian preference or preferences may be in flux. In such circumstances, should legislators favor the traditional view or the one that seems to be emerging? Should legislators look to how the issue is typically addressed in professionally drafted wills? Should the law of inheritance, which is oriented toward implementing the probable intent of the typical decedent, consider also the family law policy of the best interests of the child?

Manifestly, teaching the law of intestacy need not entail a dry survey of mechanical rules. Policy debate over intestacy is fraught with questions of morality and the proper role of the state in establishing social norms. Some have argued that shaping social norms and other such policies are appropriate considerations in designing intestacy statutes. Thus, some have advocated for the recognition of unmarried committed partners, both same-sex and opposite-sex, as intestate takers on the grounds that this would be a validation of the propriety of such relationships. Other commentators have pushed back, arguing against the use of intestacy laws to shape social norms.<sup>13</sup> The stakes extend beyond intestate succession, because the law of intestacy supplies rules of construction applicable to wills, trusts, and other will substitutes. Intestacy law is also influential or even determinative of other questions, such as who qualifies for Social Security survivor benefits.<sup>14</sup>

### III. WILLS: FORMALITIES AND FORMS

The probate code of every state includes a provision, known for historical reasons as the *Wills Act*, which prescribes rules for making a valid *will*. A person who makes a will, known as a *testator*, is said to die *testate*. The

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12. See, e.g., Kristine S. Knaplund, *Children of Assisted Reproduction*, 45 U. MICH. J.L. REFORM 899, 899–900 (2012).

13. See, e.g., RALPH C. BRASHIER, *INHERITANCE LAW AND THE EVOLVING FAMILY* (2004); Frances H. Foster, *The Family Paradigm of Inheritance Law*, 80 N.C. L. REV. 199 (2001); Susan N. Gary, *The Probate Definition of Family: A Proposal for Guided Discretion in Intestacy*, 45 U. MICH. J.L. REFORM 787 (2012); Adam J. Hirsch, *Default Rules in Inheritance Law: A Problem in Search of Its Context*, 73 FORDHAM L. REV. 1031 (2004); Ronald J. Scalise, Jr., *Honor Thy Father and Mother?: How Intestacy Law Goes Too Far in Protecting Parents*, 37 SETON HALL L. REV. 171 (2006); E. Gary Spitko, *The Expressive Function of Succession Law and the Merits of Non-Marital Inclusion*, 41 ARIZ. L. REV. 1063 (1999); Lee-ford Tritt, *Technical Correction or Tectonic Shift: Competing Default Rule Theories Under the New Uniform Probate Code*, 61 ALA. L. REV. 273 (2010).

14. See *Astrue v. Capato*, 132 S. Ct. 2021, 2028–33 (2012).

probate property of a testate decedent is distributed in accordance with the decedent's will. By complying with the Wills Act, a testator can ensure that his or her property is distributed in accordance with his or her actual intent rather than the presumed intent of intestacy. In this way, the Wills Act implements the principle of freedom of disposition.

A will is a peculiar legal instrument, however, in that it does not take effect until after the testator dies. As a consequence, probate courts follow what has been called a "worst evidence" rule of procedure.<sup>15</sup> The witness who is best able to authenticate the will, to verify that it was voluntarily made, and to clarify the meaning of its terms is dead by the time the court considers such issues. The law of wills must therefore overcome the worst evidence problem in discerning the *authenticity*, the *voluntariness*, and the *meaning* of a will.

Let us begin with the question of *authenticity*. The Wills Act of every state requires compliance with particular *formalities* for making or revoking a will.<sup>16</sup> The main purpose of these formalities is to enable a court easily and reliably to discern the authenticity of a purported act of testation.<sup>17</sup> The Wills Act also serves protective, cautionary, and channeling functions. The challenge is to prescribe a set of formalities, and a rule for the exactness with which those formalities must be complied, that balances the risk of probating an inauthentic will with the risk of denying probate to an authentic will.<sup>18</sup> Both kinds of error dishonor the decedent's freedom of disposition. The former gives effect to a false expression of testamentary intent; the latter denies effect to a true expression of testamentary intent.

Under traditional law, a will may be admitted to probate only if it is in *strict compliance* with the formal requirements of the applicable Wills Act. The will must be in writing, signed by the testator, and attested by at least two witnesses. Any additional requirements that might be mandated by the applicable Wills Act must also be satisfied exactly.<sup>19</sup> The strict compliance rule guards against a spurious finding of authenticity—a *false positive*. A competent person not subject to undue influence, duress, or fraud is unlikely to execute an instrument in strict compliance with all of the Wills Act formalities unless the person intends the instrument to be his or her will. But by

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15. John H. Langbein, *Will Contests*, 103 YALE L.J. 2039, 2046 (1994) (book review).

16. Formalities for making a testamentary disposition are ubiquitous across legal systems. See 1 COMPARATIVE SUCCESSION LAW: TESTAMENTARY FORMALITIES (Kenneth G.C. Reid, Marius J. de Waal & Reinhard Zimmermann eds., 2011).

17. See Ashbel G. Gulliver & Catherine J. Tilson, *Classification of Gratuitous Transfers*, 51 YALE L.J. 1, 3 (1941).

18. See John H. Langbein, *Substantial Compliance With the Wills Act*, 88 HARV. L. REV. 489 (1975).

19. See JEFFREY A. SCHOENBLUM, 2013 MULTISTATE GUIDE TO ESTATE PLANNING tbl. 1 (2012) (collecting state Wills Act requirements).

establishing a conclusive presumption of invalidity for an imperfectly executed instrument, the strict compliance rule denies probate even if the defect is innocuous and there is overwhelming evidence of authenticity—a *false negative*.<sup>20</sup>

Modern law has shifted the balance, reflecting a different calculus of error costs and decision costs, by reducing the number of required formalities and by relaxing the exactness with which they must be satisfied. The Wills Act of the Uniform Probate Code requires only the bare minimum formalities of writing, signature, and attestation.<sup>21</sup> The *harmless error rule*, now adopted in ten states, reworks the conclusive presumption of invalidity for an imperfect execution into a rebuttable presumption that can be overcome with clear and convincing evidence that the decedent intended the instrument to be his or her will.<sup>22</sup> An emerging difficulty in the modern cases, therefore, is in differentiating evidence of the decedent's dispositive intent from evidence that the decedent meant for a particular instrument to be controlling of his or her dispositions at death.<sup>23</sup>

Revocation of wills raises mirror-image questions of authenticity, complicated by the need to allow for physical act revocation. A testator who, say, urinates on and then sets fire to his or her will has communicated that he or she no longer wants his property to be distributed at death in accordance with that will.<sup>24</sup> What useful purpose is served by denying effect to this clearly manifested revocatory intent? The question of authenticity is also at play in applying the doctrines of integration, incorporation by reference, republication by codicil, and acts of independent significance. Under those doctrines, unattested documents or lifetime acts may determine who takes what from the testator's estate. Still another area in which the question of authenticity is raised is in contracts to make or not to revoke a will. Because the worst evidence problem pertains to such contracts, most states subject them to the Statute of Frauds or at least require proof by clear and convincing evidence.

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20. See Daniel B. Kelly, *Toward Economic Analysis of the Uniform Probate Code*, 45 U. MICH. J.L. REFORM 855, 877–82 (2012).

21. UNIF. PROBATE CODE § 2-502(a) (2008).

22. See *id.* § 2-503; RESTATEMENT (THIRD) OF PROP.: WILLS AND OTHER DONATIVE TRANSFERS § 3.3 (2003). For a listing of the ten states and a map, see DUKEMINIER & SITKOFF, *supra* note 2, at 184–85.

23. Compare *In re Probate of Will and Codicil of Macool*, 3 A.3d 1258, 1262–64 (N.J. Super. Ct. App. Div. 2010) (making this point), with *In re Estate of Kuralt*, 15 P.3d 931, 933–34 (Mont. 2000) (blurring the distinction).

24. See *In re Estate of Stoker*, 122 Cal. Rptr. 3d 529 (Cal. Ct. App. 2011).

## IV. WILLS: CAPACITY AND CONTESTS

As we have seen, by making a will a person can direct the distribution of his or her probate property at death, overriding the default distribution of intestacy. But what if a will, although properly executed and so authentic, was not *voluntarily* made? It follows from the principle of freedom of disposition that only a volitional act of testation should be enforced. Enter the *will contest*.

In a will contest, the contestant alleges that a will executed with proper formalities was nonetheless not volitional because of the *incapacity* of the testator or the *undue influence, duress, or fraud* of another. The mirror-image claim, that the decedent would have made a new will but for the undue influence, duress, or fraud of another, is also possible. An unexecuted will cannot be probated, but the decedent's frustrated intent can be honored in *restitution*, preventing *unjust enrichment*, by imposing a *constructive trust* in favor of the decedent's intended beneficiary.<sup>25</sup>

The complication in these matters, as before, is the worst evidence rule of probate procedure whereby the best witness is dead by the time the question is litigated. The line between indelicate but lawful persuasion on the one hand, and undue influence and duress on the other, can be difficult to assess in posthumous litigation. Distinguishing between the peculiarities of old age and true mental infirmity can be equally vexing. Judges and juries may be tempted to find undue influence or incapacity if the testator's dispositions seem unfair or unnatural.<sup>26</sup>

The law attempts to balance the risk of giving effect to an involuntary act of testation (a false positive) with the risk of denying effect to a voluntary one (a false negative). If courts are too reluctant to set aside a will, the unscrupulous will find profit in subverting vulnerable testators. But if courts are too willing to set aside a will, disappointed expectant beneficiaries will find profit in holding up an estate with a contest meant to extract a settlement. The difficult task for lawmakers is in striking the right balance. And the difficult task for practicing lawyers is in planning for and avoiding a will contest if warning signs are present.<sup>27</sup>

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25. See RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 46 cmt. e (2011).

26. See, e.g., Irene D. Johnson, *There's a Will, But No Way—Whatever Happened to the Doctrine of Testamentary Freedom and What Can (Should) We Do to Restore It?*, 4 EST. PLAN. & COMMUNITY PROP. L.J. 105 (2011); Melanie B. Leslie, *The Myth of Testamentary Freedom*, 38 ARIZ. L. REV. 235 (1996); Ray D. Madoff, *Unmasking Undue Influence*, 81 MINN. L. REV. 571 (1997); E. Gary Spitko, *Gone But Not Conforming: Protecting the Abhorrent Testator from Majoritarian Cultural Norms Through Minority-Culture Arbitration*, 49 CASE W. RES. L. REV. 275 (1999); Carla Spivack, *Why the Testamentary Doctrine of Undue Influence Should Be Abolished*, 58 U. KAN. L. REV. 245 (2010).

27. See DUKEMINIER & SITKOFF, *supra* note 2, at 309–13.



The voluntariness of a will can be put into issue by a claim of mental incapacity or insane delusion, which is a question of *status*, or by a claim of wrongdoing by a third party in the form of undue influence, duress, or fraud, which is a question of *conduct*. In practice, status and conduct claims tend to overlap, because the mental ability of the testator is relevant to assessing his vulnerability to influence by others. Even if a testator satisfies the low standard for testamentary capacity, evidence of diminished mental ability is a relevant factor in assessing susceptibility to wrongdoing by a third party.<sup>28</sup>

The most important of the conduct doctrines is undue influence. The Restatement (Third) of Property says, “A donative transfer is procured by undue influence if the influence exerted over the donor overcame the donor’s free will and caused the donor to make a donative transfer that the donor would not otherwise have made.”<sup>29</sup> But what influence is *undue*? The line between indelicate but permissible persuasion and influence that is undue is not always clear. Moreover, because direct evidence of undue influence is rare, contestants must typically rely on circumstantial evidence. To impose order on the unruly concept of undue influence and to clarify the scope of admissible evidence, the law has evolved an elaborate scheme of inferences, presumptions, and burden shifting that reflect long experience with protecting the decedent’s freedom of disposition against imposition by cunning or domineering persons.<sup>30</sup>

Although claims of lack of volition have long been the province of will contests and actions in restitution, in recent years tort has begun to encroach on this turf. In nearly half the states a new tort of interference with inheritance has emerged as a rival cause of action for cases involving undue influence, duress, or fraud. Some commentators have applauded this development, seeing in the tort a useful gap filler, but in my view it is at best a redundancy—and probably a pernicious one at that. Because the interference-with-inheritance tort recognizes a primary right in a prospective donee to inherit, it is in deep tension with the principle of freedom of disposition. And because the tort is governed by more lax procedures than in a will contest or restitution action, it allows disappointed expectant beneficiaries to plead around the stricter procedures that evolved within the law of succession to address the worst evidence problem.<sup>31</sup>

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28. A familiar teaching example is *Estate of Lakatos*, 656 A.2d 1378, 1384–85 (Pa. Super. Ct. 1995).

29. RESTATEMENT (THIRD) OF PROP.: WILLS AND OTHER DONATIVE TRANSFERS § 8.3(b) cmt. e (2003).

30. See DUKEMINIER & SITKOFF, *supra* note 2, at 290–91.

31. See John C.P. Goldberg & Robert H. Sitkoff, *Torts and Estates: Remedying Wrongful Interference with Inheritance*, 65 STAN. L. REV. 335 (2013).

## V. WILLS: CONSTRUCTION

A will that is authentic and volitional is entitled to probate. The testator's estate must be distributed in accordance with the terms of the will. This brings us to the *construction of wills*, that is, the process of determining the *meaning* that should be attributed to a will. In accordance with the principle of freedom of disposition, "[t]he controlling consideration in determining the meaning of a donative document is the donor's intention."<sup>32</sup> But how should a testator's intention be determined? The words of a will are sometimes ambiguous or may suggest an intent different from what other evidence indicates was the testator's actual or likely intent.

The complication is once again the worst evidence rule whereby the witness best able to clarify the meaning of the will is dead by the time the question is litigated. Without live testimony from the testator, how should a court go about discerning the testator's intent? Should a court enforce the *plain meaning* of the will, excluding all *extrinsic evidence* of intent? What if the language of the will is ambiguous on its face? What if a seemingly clear provision is ambiguous as applied to the facts? What if clear and convincing evidence shows that the language of the will is mistaken owing to an innocent mistake by the scrivener? Should courts have the power to *reform* a will to correct a mistaken term?

Under traditional law, compliance with the Wills Act establishes a conclusive validation of the written words of the will that may not be challenged on the basis of extrinsic evidence of a different intent. Extrinsic evidence may be admitted to resolve certain ambiguities, but the plain meaning of the words of a will cannot be disturbed by evidence that the testator intended another meaning. Courts may not reform a will to correct a mistaken term to reflect what the testator intended the will to say. In this way, traditional law guards against a spurious finding of mistake (a false positive). But this benefit comes at the cost of denying relief even if there is overwhelming evidence of mistake and the testator's actual intent (a false negative).

To avoid this harsh result, courts have sometimes corrected a mistake under the guise of using extrinsic evidence to construe a supposedly ambiguous term.<sup>33</sup> In other cases, the need to resort to extrinsic evidence was too obvious to deny, such as in a bequest of "the sum of two hundred thousand dollars (\$25,000)."<sup>34</sup> Eventually, a movement began toward formally relaxing

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32. RESTATEMENT (THIRD) OF PROP.: WILLS AND OTHER DONATIVE TRANSFERS § 10.1.

33. See, e.g., *Arnheiter v. Arnheiter*, 125 A.2d 914 (N.J. Super. Ct. Ch. Div. 1956) (construing "No. 304 Harrison Avenue" to mean "No. 317 Harrison Avenue"); *In re Estate of Gibbs v. Krause*, 111 N.W.2d 413 (Wis. 1961) (construing "Robert J. Krause" to mean "Robert W. Krause").

34. *In re Estate of Cole*, 621 N.W.2d 816, 817 (Minn. Ct. App. 2001).

the rules against extrinsic evidence and reformation.<sup>35</sup> As in the movement to reform execution formalities, the movement to reform construction of wills argued for a rebalancing of decision costs and error costs.<sup>36</sup> Today the Uniform Probate Code, the Restatement (Third) of Property, and a minority but growing number of courts permit recourse to extrinsic evidence to clarify and even reform the terms of a will.<sup>37</sup> Notably, opponents of this movement speak in similar functional terms, arguing that traditional law better balances the problem of false positives and false negatives.<sup>38</sup>

Another difficulty in construing wills stems from the gap in time that intervenes between the making of a will and the testator's death. During this gap, which may span years or even decades, circumstances can change in a way that renders the will stale or obsolete. A named beneficiary might predecease the testator or the nature and scope of the testator's property might change. How is a *stale will* to be applied to changed circumstances? In these cases, if the testator's actual intent is not evident, courts apply rules of construction that are meant to implement the probable intent of the typical testator.<sup>39</sup>

## VI. TRUSTS: CREATION AND CHARACTERISTICS

In contemporary practice, trusts have eclipsed wills as the preferred vehicle for implementing a donor's freedom of disposition. A *trust* is, functionally speaking, a legal arrangement created by a *settlor* in which a *trustee* holds property as a *fiduciary* for one or more *beneficiaries*. The trustee takes *legal title* to the trust property, which allows the trustee to deal with third parties as owner of the property. The beneficiaries have *equitable title* to the trust property, which allows them to hold the trustee accountable for breach of the trustee's fiduciary duties. The beneficiaries are typically entitled to periodic distributions from the trust income and sometimes from the trust principal as well.

Trusts may be *testamentary*, created by will and arising in probate. Or they may be *inter vivos*, created during the settlor's life by *declaration of trust* or by *deed of trust*, often as a *will substitute* to avoid probate. "The purposes for

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35. See John H. Langbein & Lawrence W. Waggoner, *Reformation of Wills on the Ground of Mistake: Change of Direction in American Law?*, 130 U. PA. L. REV. 521 (1982).

36. See Kelly, *supra* note 20, at 889–90.

37. See UNIF. PROBATE CODE § 2-805 (2008); RESTATEMENT (THIRD) OF PROP.: WILLS AND OTHER DONATIVE TRANSFERS § 12.1.

38. See, e.g., Flannery v. McNamara, 738 N.E.2d 739, 746 (Mass. 2000) (expressing concern that reformation "would open the floodfates of litigation and lead to untold confusion in the probate of wills").

39. See Adam J. Hirsch, *Text and Time: A Theory of Testamentary Obsolescence*, 86 WASH. U. L. REV. 609 (2009) (surveying doctrines dealing with stale wills).

which we can create trusts,” says the leading treatise, “are as unlimited as our imagination.”<sup>40</sup> These uses range from providing financial support for a surviving spouse and children in accordance with their respective needs, to structuring commercial enterprises such as mutual funds and asset securitization. The key to the trust’s versatility as an instrument for conveyance and management of property is that it “separate[s] the benefits of ownership from the burdens of ownership.”<sup>41</sup>

The typical Trusts and Estates course focuses on the use of the trust in gratuitous transfers as a will substitute and as a management device for fiduciary administration on behalf of others. In both contexts, the trust implements the principle of freedom of disposition by projecting the donor’s will across time. But there are important differences. As a will substitute, the trust is an instrument of conveyance. As a management device, the trust is used to impose ongoing fiduciary intermediation. Owing to these different contexts, different rules have developed for each type of trust, in effect a fracturing of the trust canon into two distinct branches.<sup>42</sup> Still a third branch is the law of business trusts,<sup>43</sup> but they are rarely mentioned in the Trusts and Estates course because they involve an exercise of *freedom of contract* rather than freedom of disposition.<sup>44</sup>

Before getting into the law of trust creation, it is useful to consider the basic functional elements of a trust; the history of the trust; the sources of modern trust law and the role of the great treatises, the Restatements, and the uniform laws; the varied uses of the trust in contemporary practice; and the *bifurcation of ownership* that is the hallmark characteristic of the trust relationship. Two categories of issues arise from bifurcating legal and equitable ownership: (1) the effect on the rights of third parties with respect to the trust property and the property of the trustee personally (*asset partitioning*), and (2) the powers and duties of the trustee and the corresponding rights of the

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40. 1 AUSTIN WAKEMAN SCOTT, WILLIAM FRANKLIN FRATCHER & MARK L. ASCHER, SCOTT AND ASCHER ON TRUSTS 4 (4th ed. 2006).

41. *Id.*

42. See DUKEMINIER & SITKOFF, *supra* note 2, at 583.

43. See Robert H. Sitkoff, *Trust as “Uncorporation”*: A Research Agenda, 2005 U. ILL. L. REV. 31 (2005); Steven L. Schwarcz, *Commercial Trusts as Business Organizations: Unraveling the Mystery*, 58 BUS. LAW. 559 (2003); John H. Langbein, *The Secret Life of the Trust: The Trust as an Instrument of Commerce*, 107 YALE L.J. 165 (1997).

44. In describing these three branches of trust law, I put to the side the *constructive trust*, which is a remedy commonly imposed to prevent unjust enrichment, and the *resulting trust*, which is an equitable reversionary interest.

beneficiaries with respect to the trust property and against the trustee (*fiduciary administration*).<sup>45</sup>

The rules governing the creation of a trust are important in their own right and because they distinguish the trust from other kinds of property arrangements. The creation of a trust requires (1) *intent* by the settlor to create a trust; (2) *ascertainable beneficiaries* who can enforce the trust; and (3) specific *property*, the *res*, to be held in trust. In finding the intent needed to create a trust, it is useful to draw a distinction between a testamentary trust, to which the law governing the construction of wills applies, and an *inter vivos* trust, which can arise informally and, if by declaration of trust, without a conveyance of property or the involvement of a third party. The requirement of an ascertainable beneficiary follows from the basic principle of fiduciary law that a fiduciary relationship requires a beneficiary who can call the fiduciary to account, and from the fundamental principle of trust law that a private trust must be for the benefit of the beneficiaries. The requirement of specific property is what distinguishes a trust from a debt, giving the trust many of its asset partitioning, proprietary features.<sup>46</sup>

The law of trusts, standing alone, does not require a writing to create a trust. An oral *inter vivos* trust of personal property, whether by declaration or by transfer to another as trustee, is permitted.<sup>47</sup> However, if the trust is testamentary or is to hold land, a writing is usually necessary to satisfy the Wills Act or the Statute of Frauds. An oral trust for the disposition of personal property at death, although permissible, is in tension with the policy values of the Wills Act. And the central policy of the law of restitution, preventing unjust enrichment, sometimes calls for relief by way of constructive trust if an oral trust fails for noncompliance with the Wills Act or the Statute of Frauds.

## VII. NONPROBATE TRANSFERS AND PLANNING FOR INCAPACITY

Having surveyed probate succession by will and by intestacy, and having introduced the trust form, we are ready to consider the *will substitutes*: revocable trusts, life insurance and other pay-on-death contracts, pension plans and retirement accounts, and other such arrangements that have the effect of passing property at death outside of probate. Taken together, the will substitutes constitute a nonprobate system of private succession that competes

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45. See Robert H. Sitkoff, *Trust Law as Fiduciary Governance Plus Asset Partitioning*, in *THE WORLDS OF THE TRUST* 428 (Lionel Smith ed., 2013).

46. See Henry Hansmann & Ugo Mattei, *The Functions of Trust Law: A Comparative Legal and Economic Analysis*, 73 N.Y.U. L. REV. 434 (1998).

47. See RESTATEMENT (THIRD) OF TRUSTS § 20 (2003).

with the public probate system.<sup>48</sup> More wealth passes by way of will substitutes than in probate.

The rise of private succession raises two legal questions that have vexed courts and policymakers. First, must a will substitute be executed with *Wills Act formalities* to be valid? Should the evidentiary, protective, cautionary, and channeling policies of the Wills Act apply to will substitutes? Are those policies served by alternative formalities or, for some will substitutes, the presence of a neutral financial intermediary? The prevailing view in modern law is that the will substitutes are valid even if not executed with Wills Act formalities.<sup>49</sup>

Second, to what extent should the *subsidiary law of wills* apply to will substitutes? By subsidiary law of wills I refer both to policy-based substantive limits on testation by will, such as creditors' rights and the forced share for a surviving spouse, and to rules of construction, such as antilapse, simultaneous death, and revocation on divorce. The Restatement (Third) of Property says that the subsidiary law of wills is applicable to a will substitute "to the extent appropriate."<sup>50</sup> But what criteria should apply in determining appropriateness? Are there circumstances in which a person should be able to avoid a creditor's claim or a spouse's forced share by reconfiguring his or her transfer to take the form of a will substitute? And what of the rules of construction, which evolved out of long experience with interpreting and administering testamentary dispositions in accordance with the donor's probable intent? Each will substitute is governed by its own field of law, such as contract law or trust law, which may be in conflict with the law of wills. How should such conflicts be resolved? An added complication is that most pensions and life insurance policies that are obtained as a benefit of employment are governed by federal law, which preempts state law.<sup>51</sup>

As a practical matter, the use of multiple will substitutes can result in an estate plan that lacks coordination. Many will substitutes are asset specific, but sensible estate planning is holistic. To deal with this problem, many lawyers recommend creating a revocable trust and making it the beneficiary of the client's will (a "pour-over will") and various will substitutes.<sup>52</sup> The revocable

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48. See John H. Langbein, *The Nonprobate Revolution and the Future of the Law of Succession*, 97 HARV. L. REV. 1108, 1108 (1984).

49. See RESTATEMENT (THIRD) OF PROP.: WILLS AND OTHER DONATIVE TRANSFERS § 7.1 (2003).

50. *Id.* § 7.2.

51. See *Egelhoff v. Egelhoff*, 532 U.S. 141 (2001).

52. The vernacular of American trust practice reifies the trust, referring to it as if it were an entity. Although technically incorrect, reifying the trust provides a convenient shorthand, "the trust," for the technically correct but more awkward locution of "the trustee acting in his fiduciary capacity as trustee." See Sitkoff, *supra* note 45, at 436.

trust has thus emerged as the successor to the will as the centerpiece in contemporary estate planning.

To adapt the trust to this use, the law of revocable trusts has evolved into a distinct branch of trust law.<sup>53</sup> Canonical authority tells us that a trust is a fiduciary relationship in which a trustee holds title to certain property subject to fiduciary duties to administer it for the benefit of one or more beneficiaries.<sup>54</sup> Yet in modern law a revocable trust need not have property, at least not initially, if it is to be funded by a pour-over will.<sup>55</sup> Moreover, the trustee of a revocable trust does not owe fiduciary duties to the beneficiaries, but rather is subject to the control of the settlor for as long as the trust remains revocable.<sup>56</sup> In modern practice, therefore, a revocable trust is little more than a nonprobate will that avoids the burdens of probate in a manner reminiscent of how trusts were once used to defeat primogeniture and the feudal incidents.<sup>57</sup>

The emphasis on revocable trusts in nonprobate transfers provides a segue, albeit imperfect, to the challenge of planning for the possibility of a person's future incapacity.<sup>58</sup> It is a sad fact of the human condition that a period of mental and physical decay may precede death in old age. Planning for incapacity is therefore as much a part of estate planning practice as planning for death. Such planning should address both property management and health care decision making for an incapacitated person. Today there are statutory default rules for these matters, but proper planning will displace those rules by way of revocable trusts, durable powers of attorney, and health care directives. The imposition of a conservatorship or guardianship is a deprivation of liberty that requires due process.<sup>59</sup> Avoiding such a proceeding by advance planning is in effect a waiver of that process.

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53. This is reflected in Article 6 of the Uniform Trust Code, which is "among the Code's most important and innovative provisions." David M. English, *The Uniform Trust Code (2000): Significant Provisions and Policy Issues*, 67 MO. L. REV. 143, 186 (2002).

54. See RESTATEMENT (THIRD) OF TRUSTS § 2 (2003).

55. See, e.g., UNIF. PROBATE CODE § 2-511 (2008).

56. See UNIF. TRUST CODE § 603(a) (rev. 2010); RESTATEMENT (THIRD) OF TRUSTS § 74.

57. See DUKEMINIER & SITKOFF, *supra* note 2, at 387.

58. Perhaps a more natural fit would be to address this subject in connection with planning to avoid will contests and testamentary capacity, see *supra* notes 25–31 and accompanying text, but at that early stage the students have not yet been exposed to revocable trusts or the concept of fiduciary obligation.

59. Even the modern Uniform Probate Code provides for an elaborate court procedure to protect an alleged incompetent. See UNIF. PROBATE CODE § 5-406.

VIII. LIMITS ON FREEDOM OF DISPOSITION:  
PROTECTION OF THE SPOUSE AND CHILDREN

As we have seen, the American law of succession is built on the principle of freedom of disposition. But this principle is not absolute. In all but one of the separate property states, a surviving spouse is entitled to an *elective* or *forced share*, typically one-third, of the decedent spouse's estate. In the community property states, each spouse owns all earnings during the marriage in equal, undivided shares. There is no elective share because the surviving spouse already owns half of the couple's community property. Waiver of these marital property rules is permitted, hence premarital and marital agreements are as much a part of trusts and estates practice as they are matrimonial practice.

Although there is general agreement across the states on the basic policy of protecting spouses, there is wide variation in the particulars. Many of the differences reflect a lack of consensus on whether such protections derive from a marital *support obligation* or rather are based on a *partnership theory* of marriage. The partnership theory points toward giving a surviving separate property spouse one-half of the decedent's property acquired during the marriage, mirroring the outcome in a community property state. The support theory, by contrast, would tend to justify a smaller percentage but would apply it to all of the decedent's property. It might also justify the survivor receiving all of the decedent's property up to a certain minimum amount or considering other resources available to the survivor. Which of these theories will give a surviving spouse a larger amount depends on the aggregate value of the decedent's property and how much of it was acquired during the marriage.

Another source of divergence, raising an interesting question of the role of courts versus legislatures in the making of elective share policy, is the extent to which the elective share applies to nonprobate property. The original elective share statutes gave the surviving spouse a third of the decedent's *estate*. In this context, the term estate was understood to mean the *probate estate*. With the increasing importance of nonprobate modes of transfer, the question arises whether the elective share should also apply to nonprobate transfers. For a time, it appeared that courts might gloss the elective share statutes to bring in nonprobate transfers.<sup>60</sup> But more recent cases, reflecting the displacement of purposive interpretation by textualism, have held that the elective share applies only to those nonprobate transfers, if any, that are specifically enumerated in the state's elective share statute.<sup>61</sup>

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60. See, e.g., *Sullivan v. Burkin*, 460 N.E.2d 572 (Mass. 1984).

61. See, e.g., *In re Estate of Myers*, 825 N.W.2d 1 (Iowa 2012); *In re Estate of George*, 265 P.3d 222 (Wyo. 2011); *Bongaards v. Millen*, 793 N.E.2d 335 (Mass. 2003).



In contrast to the surviving spouse, in the American legal tradition a surviving child has no rights to a mandatory share. A property owner may disinherit his or her blood relations, including children.<sup>62</sup> This rule stands in stark contrast with the other common law countries, where courts may override a testator's will for a child or other dependent of the testator.<sup>63</sup>

Both separate property and community property states protect a *pretermitted* surviving spouse from accidental disinheritance by way of a premarital will that the decedent spouse neglected to update after the marriage. American law also protects a child who is accidentally omitted from a will, such as child born after the execution of a will that does not contemplate subsequent children. But these statutes provide for default rules that may be overcome by express language in the will. The pretermitted heir statutes are therefore not limitations on freedom of disposition, but rather are meant to implement it. They are best understood as stale will doctrines, implementing the probable intent of the typical testator in dealing with changes in circumstances in the gap between a will's execution and the testator's death.<sup>64</sup>

#### IX. TRUSTS: FIDUCIARY ADMINISTRATION

The hallmark characteristic of a common law trust is bifurcation: the trustee holds *legal title* to the trust property, and the beneficiaries have *equitable* or *beneficial ownership*. This separation of legal and beneficial ownership offers many advantages. For example, property transferred in trust during life avoids probate at the settlor's death. Because the trustee holds legal title to the property, there is no need to change title by probate administration upon the settlor's death. Another advantage, characteristic of an irrevocable trust, is fiduciary intermediation between the beneficiary and the trust property. The trust is therefore a powerful tool for implementing a donor's freedom of disposition across time.

By making a transfer in trust rather than outright, a settlor ensures that the property will be managed and distributed in accordance with his or her wishes as expressed in the terms of the trust rather than the whims of the beneficiaries. A trust also allows the settlor to postpone important decisions about the investment and distribution of the trust property. Instead of imposing inflexible instructions in advance, the settlor may empower the trustee to decide how the

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62. See Deborah A. Batts, *I Didn't Ask to Be Born: The American Law of Disinheritance and a Proposal for Change to a System of Protected Inheritance*, 41 HASTINGS L.J. 1197, 1197-1200 (1990).

63. See, e.g., Inheritance (Provision for Family and Dependents) Act, 1975, c. 63, § 1 (Eng. & Wales).

64. See *supra* note 39 and accompanying text.

property should be invested and distributed in light of changing market conditions and the beneficiaries' evolving circumstances and capabilities.

The intermediary role of the trustee involves custody, administration, investment, and distribution of the trust property in accordance with the terms of the trust.<sup>65</sup> The *custodial* function involves taking custody of the trust property and properly safeguarding it. The *administrative* function includes accounting and recordkeeping, as well as making tax and other required filings. The *investment* function involves reviewing the trust assets and making and implementing an investment program for those assets as part of an overall strategy reasonably suited to the purpose of the trust and the circumstances of the beneficiaries. The *distribution* function involves making disbursements of income or principal to the beneficiaries in accordance with the terms of the trust. In contemporary practice, naming a professional trustee and dividing the functions of trusteeship among different persons has become increasingly common.

Empowering the trustee, however, puts the beneficiaries at the peril of mismanagement or even misappropriation—a problem of *agency costs*.<sup>66</sup> In the days of yore, when the trust was used more for conveying land than for ongoing administration of property, trust law minimized agency costs by giving the trustee only limited powers. In modern practice, in which trusts are commonly used to facilitate ongoing management of property on behalf of the beneficiaries, the trustee is given broad *powers* of administration, but the exercise of those powers is subject to the trustee's *fiduciary duties*.<sup>67</sup> The Restatement (Third) of Trusts characterizes this as “a basic principle of trust administration,” namely, that “a trustee presumptively has comprehensive powers to manage the trust estate and otherwise to carry out the terms and purpose of the trust, but that all powers held in the capacity of trustee must be exercised, or not exercised, in accordance with the trustee's fiduciary obligations.”<sup>68</sup>

Accordingly, the purpose of trust fiduciary law is to suppress agency costs by inducing the trustee to adhere to the terms of the trust and to act prudently

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65. The four functions noted above are an extension of the three suggested in John H. Langbein, *The Uniform Prudent Investor Act and the Future of Trust Investing*, 81 IOWA L. REV. 641, 665 (1996).

66. See Robert H. Sitkoff, *An Agency Costs Theory of Trust Law*, 89 CORNELL L. REV. 621 (2004).

67. See John H. Langbein, *The Contractarian Basis of the Law of Trusts*, 105 YALE L.J. 625, 640, 642 (1995) (explaining the rise of fiduciary law as a substitute for limited powers to safeguard the beneficiary).

68. RESTATEMENT (THIRD) OF TRUSTS § 70 cmt. a (2003).

and in the best interests of the beneficiaries.<sup>69</sup> Viewed in this manner, the fiduciary governance strategy of modern trust law is intuitive. The functional core is *deterrence*. The fiduciary is induced to act in the best interests of the beneficiary by the threat of after-the-fact liability for breach of fiduciary duty. The core fiduciary duties are the duties of *loyalty* and *prudence*. The duty of *loyalty* proscribes misappropriation and regulates conflicts of interest by requiring the fiduciary to act in the sole interests of the beneficiaries. The duty of *prudence* prescribes the fiduciary's standard of care by establishing an objective prudence or reasonableness standard the meaning of which is informed by industry norms and practices.

Accumulated experience with recurring, common sets of facts and circumstances has led to the development of a host of *implementing* or *subsidiary rules*. These rules flesh out the duties of loyalty and prudence as applied to recurring circumstances for which customary practice has hardened into rules of law. The no-further-inquiry rule and its proliferating exceptions are an example. Another is the prudent investor rule, which is a specification of the duty of prudence in the investment function.<sup>70</sup> Still other examples are the duties to collect and protect trust property; to earmark that property as belonging to the trust and not commingle it with the trustee's own property; to keep adequate records of the trust property and the administration of the trust; and to bring and defend claims held in trust. Yet another subsidiary rule, of significant practical relevance, is the duty of the trustee to make affirmative disclosure to the beneficiary of nonroutine transactions and other significant developments in the administration of the trust.<sup>71</sup>

In the event of a breach of duty by a trustee, the beneficiary is entitled to an election among remedies that include *compensatory damages* to restore the trust estate and trust distributions to what they would have been but for the breach. In addition, the beneficiary is entitled to *disgorge* the trustee of any profit made on the transaction. The justification for compensation is that the beneficiary is entitled to be made whole for any losses incurred or gains foregone owing to the breach. But compensatory damages will not deter breach if the gains to the breaching party exceed the nonbreaching party's loss. The availability of a disgorgement remedy, which allows the beneficiary to take the trustee's gain even in excess of making the trust whole, reflects the additional

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69. This discussion is derived from Robert H. Sitkoff, *The Economic Structure of Fiduciary Law*, 91 B.U. L. REV. 1039, 1042–43 (2011).

70. See Max M. Schanzbach & Robert H. Sitkoff, *Did Reform of Prudent Trust Investment Laws Change Trust Portfolio Allocation?*, 50 J.L. & ECON. 681 (2007); Langbein, *supra* note 65.

71. The leading case is *Allard v. Pac. Nat'l Bank*, 663 P.2d 104, 110 (Wash. 1983) (en banc). Examples of significant developments are collected in RESTATEMENT (THIRD) OF TRUSTS § 82 cmt. d.

deterrent and disclosure purposes of fiduciary law. Because the trustee is not entitled to keep the gains from breach, the trustee is deterred from unilateral breach, and is instead given an incentive to disclose the potential gains from breach and seek the beneficiary's consent.<sup>72</sup> In effect, the (penalty) default rule in trust fiduciary law is that all profits by the trustee traceable to the fiduciary relationship are held in trust unless agreed otherwise. The law in this area denies the possibility, permitted in contract law, of unilateral efficient breach.

Thus far I have been speaking of the trustee's fiduciary duties to the beneficiaries. This is consistent with traditional doctrine, under which a beneficiary or a co-trustee, but not the settlor, has standing to sue the trustee for breach of duty.<sup>73</sup> But is not the creation of a trust an exercise of the settlor's freedom of disposition? Should not the settlor's intent prevail over the wishes of the beneficiary? Elsewhere I have argued that:

[T]he law should minimize the agency costs inherent in locating managerial authority with the trustee and the residual claim with the beneficiaries, but only to the extent that doing so is consistent with the *ex ante* instructions of the settlor. This qualification gives priority to the settlor over the beneficiaries as the trustee's primary principal. [My] positive claim is that, at least with respect to traditional doctrines, the law conforms to the suggested normative approach.<sup>74</sup>

In many respects American trust law does indeed regard the settlor as the primary principal. A beneficiary cannot easily remove the trustee, modify or terminate the trust without the settlor's consent, or alienate his or her beneficial interest. On each of those questions, American law honors the settlor's freedom of disposition over the wishes of the beneficiary. On the other hand, some of the most contentious current issues in the law of trust fiduciary administration, including whether the settlor may completely negate the trustee's duties to diversify and to give information to the beneficiaries,<sup>75</sup> are about policy limitations on freedom of disposition.

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72. This discussion is derived from Sitkoff, *supra* note 69, at 1048–49.

73. RESTATEMENT (THIRD) OF TRUSTS § 94(1).

74. Sitkoff, *supra* note 66, at 683–84. For discussion by others, some critical of my views, see, e.g., M. W. LAU, *THE ECONOMIC STRUCTURE OF TRUSTS* (2011); Jonathan R. Macey, *Private Trusts for the Provision of Private Goods*, 37 EMORY L.J. 295 (1988); Alan Newman, *The Intention of the Settlor Under the Uniform Trust Code: Whose Property Is It, Anyway?*, 38 AKRON L. REV. 649 (2005); Lee-ford Tritt, *The Limitations of an Economic Agency Cost Theory of Trust Law*, 32 CARDOZO L. REV. 2579 (2011).

75. Regarding diversification, compare John H. Langbein, *Burn the Rembrandt? Trust Law's Limits on the Settlor's Power to Direct Investments*, 90 B.U. L. REV. 375 (2010), with Jeffrey A. Cooper, *Shades of Gray: Applying the Benefit-the-Beneficiaries Rule to Trust Investment Directives*, 90 B.U. L. REV. 2383 (2010). Regarding information, see, e.g., Frances H. Foster,

## X. TRUSTS: ALIENATION AND MODIFICATION

By giving property to a trustee to hold in a fiduciary capacity, rather than giving it outright to a beneficiary, a settlor ensures that the property will be managed and distributed in accordance with his or her wishes as expressed in the terms of the trust. But what are the limits on a settlor's freedom of disposition by way of a trust? Three recurring issues within the law of trusts, each relating to alienation or modification of the beneficial interest, raise this question.

The first is the extent to which a settlor may impose a restraint on *alienation* of a beneficial interest. In all common law jurisdictions, a beneficiary of a *discretionary trust* cannot alienate his or her beneficial interest and a creditor of the beneficiary cannot compel the trustee to make a distribution. But American law goes further, recognizing a *spendthrift trust*. A beneficiary of a spendthrift trust cannot transfer his or her beneficial interest and his or her creditors cannot attach it, and this is true even if the beneficiary has a present right to a mandatory distribution.

The rationale for permitting a spendthrift trust, created by the settlor's imposition of a disabling restraint on alienation of the beneficial interest, is firmly rooted in freedom of disposition. Justice Miller's dictum in *Nichols v. Eaton* is the famous early statement:

Why a parent, or one who loves another, and wishes to use his own property in securing the object of his affection, as far as property can do it, from the ills of life, the vicissitudes of fortune, and even his own improvidence, or incapacity for self-protection, should not be permitted to do so, is not readily perceived.<sup>76</sup>

In a later case, the Pennsylvania Supreme Court elaborated:

It is always to be remembered that consideration for the beneficiary does not even in the remotest way enter into the policy of the law. It has regard solely to the rights of the donor. Spendthrift trusts can have no other justification than is to be found in considerations affecting the donor alone. They allow the donor to so control his bounty, through the creation of the trust, that it may be exempt from liability for the donee's debts, not because the law is concerned to keep the donee from wasting it, but because it is concerned to protect the donor's right of property.<sup>77</sup>

With the validity of the spendthrift trust now settled in American law, the policy debate today concerns whether to make exceptions for certain kinds of creditors, such as spouses and children or tort victims. The trend, reflected in

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*Trust Privacy*, 93 CORNELL L. REV. 555 (2008); T.P. Gallanis, *The Trustee's Duty to Inform*, 85 N.C. L. REV. 1595 (2007).

76. *Nichols v. Eaton*, 91 U.S. 716, 727 (1875).

77. *In re Morgan's Estate*, 72 A. 498, 499 (Pa. 1909).

the Uniform Trust Code, is to allow claims by spouses and children but not tort victims.<sup>78</sup> A related question, recently put into issue by novel legislation in several domestic and offshore jurisdictions, is whether to allow creditors of the settlor recourse against a *self-settled asset protection trust* in which the settlor retains a beneficial interest. To that extent, such a trust is not an exercise of freedom of disposition.<sup>79</sup>

The second issue concerns the power of a court to *modify* or *terminate* a trust. In accordance with the principle of freedom of disposition, American law has traditionally recognized only two grounds for judicial modification or termination of a trust without the settlor's consent: (1) by consent of all the beneficiaries if the modification or termination is not contrary to a *material purpose* of the settlor (the *Clafin* doctrine), and (2) *changed circumstances* not anticipated by the settlor that would defeat or substantially impair the accomplishment of the purposes of the trust (the *equitable deviation* doctrine). The material purpose rule reflects a policy judgment that the settlor's "intentions ought to be carried out."<sup>80</sup> Deviation protects the settlor's intentions against frustration by unanticipated changes in circumstances. Both doctrines are therefore firmly rooted in freedom of disposition.<sup>81</sup> In this respect American trust law is in stark contrast with English trust law, in which the beneficiaries have the right "to overbear and defeat the intention of a testator or settlor."<sup>82</sup>

The third issue concerns *trustee removal*. The policy question is how to give the trustee enough leeway to carry out the settlor's wishes without protecting lackadaisical or ineffective administration.<sup>83</sup> The balance struck by traditional law is to permit removal only for cause. A court would remove a trustee who was dishonest or who had committed a serious breach of trust, but

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78. UNIF. TRUST CODE § 503 (rev. 2010).

79. In *Phillips v. Moore*, 690 S.E.2d 620, 621 (Ga. 2010), the court quoted an earlier case thus: "The invalidity of self-settled spendthrift trusts stems from the idea that no settlor . . . should be permitted to put his own assets in a trust, of which he is [a] beneficiary, and shield those assets with a spendthrift clause, because to do so is merely shifting the settlor's assets from one pocket to another, in an attempt to avoid creditors."

80. *Clafin v. Clafin*, 20 N.E. 454, 456 (Mass. 1889).

81. Recent law reform has somewhat liberalized these rules. But most of the reforms preserve the overall aim of implementing the probable intent of the settlor. The main exception is RESTATEMENT (THIRD) OF TRUSTS § 65(2) (2003), which authorizes modification or termination by consent of the beneficiaries if the reason for modification or termination outweighs any conflicting material purpose of the settlor. This is a controversial provision, one that is more aggressive than the California statute on which it is based, and it is rejected by the Uniform Trust Code. See *DUKEMINIER & SITKOFF*, *supra* note 2, at 723–24.

82. *Goulding v. James*, [1997] 2 All E.R. 239 (A.C.) at [247] (Eng.); see also *DUKEMINIER & SITKOFF*, *supra* note 2, at 718–19.

83. See *Sitkoff*, *supra* note 66, at 663–64.

not one whose breach was minor or who had a simple disagreement with the beneficiary. Some have argued that the inability of beneficiaries to change trustees lessens competition among trust companies, contributes to higher trustees' fees, and leads to a cautious, even indifferent, style of trust management.<sup>84</sup> Modern law, reflected in the Uniform Trust Code, permits removal of a trustee by consent of all the beneficiaries if in the best interests of the beneficiaries and not contrary to a material purpose of the settlor.<sup>85</sup> This reform, which privileges the material purpose of the settlor, is thus a recalibration of how best to implement the intent of the settlor across time.

#### XI. TRUSTS: CHARITABLE PURPOSES, CY PRES, AND SUPERVISION

Through a charitable trust, a person can make a gift in support of a charitable purpose across time. In general, the same rules that apply to the formation and administration of a private trust also apply to a charitable trust. But there are three significant exceptions that differentiate a charitable trust from a private trust.<sup>86</sup>

First, a charitable trust must be for a recognized *charitable purpose* rather than for one or more ascertainable beneficiaries. "A charitable trust may be created for the relief of poverty, the advancement of education or religion, the promotion of health, governmental or municipal purposes, or other purposes the achievement of which is beneficial to the community."<sup>87</sup> The necessity of a charitable purpose, as compared to an ascertainable beneficiary, is the fundamental distinction between a private trust and a charitable trust. In modern law, however, trusts for certain noncharitable purposes, such as the care of a pet animal or the perpetual care of a grave, are also recognized, reflecting a further expansion of freedom of disposition.

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84. See, e.g., Ronald Chester & Sarah Reid Ziomek, *Removal of Corporate Trustees Under the Uniform Trust Code and Other Current Law: Does a Contractual Lens Help Clarify the Rights of Beneficiaries?*, 67 MO. L. REV. 241, 249 (2002).

85. UNIF. TRUST CODE § 706(b)(4) (rev. 2010).

86. Most charities today are structured as nonprofit corporations rather than as charitable trusts. However, much of the basic law of charitable gifts, nonprofit corporations, and charitable foundations derives from the law of charitable trusts. Accordingly, the questions of law and policy for charitable trusts apply generally across the entire charity and nonprofit sector, which is massive. In 2010, public charitable organizations reported total assets of \$2.71 trillion and revenue of \$1.51 trillion. The nonprofit sector is estimated to have contributed \$804.8 billion to the U.S. economy that year, representing 5.5 percent of the country's gross domestic product. See Amy S. Blackwood, Katie L. Roeger & Sarah L. Pettijohn, *The Nonprofit Sector in Brief: Public Charities, Giving, and Volunteering, 2012*, URBAN INST. (2010), <http://www.urban.org/UploadedPDF/412674-The-Nonprofit-Sector-in-Brief.pdf>.

87. UNIF. TRUST CODE § 405(a).

Second, because a charitable trust is exempt from the Rule Against Perpetuities and so may endure forever, it is more freely modified under the *cy pres* doctrine. *Cy pres* is shorthand for the Norman French phrase *cy pres comme possible*, meaning “as nearly as possible.” Under the *cy pres* doctrine, if a charitable trust’s specific purpose becomes *illegal*, *impossible*, or *impracticable*, the court may direct the application of the trust property to another charitable purpose that approximates the settlor’s general charitable intent. Modern law has come to recognize *wastefulness* as an additional grounds for *cy pres*. *Cy pres* addresses the risk that, because a charitable trust may have a perpetual existence, changed circumstances will render the trust’s original purpose obsolete. The doctrine implements freedom of disposition by accounting for subsequent developments in accordance with the settlor’s general charitable intent.

Third, because a charitable trust does not require an ascertainable beneficiary, traditional law relies on the *state attorney general* to ensure that the trustee remains loyal to the settlor’s charitable purpose and refrains from abuse or breach of duty. Under traditional law, the settlor does not have standing to enforce a charitable trust unless she retains an interest in it. But is supervision by the state attorneys general sufficient? The state attorney general is a political official, typically elected, with neither a personal financial stake nor, in the usual case, a political stake in the operation of a charitable trust.<sup>88</sup> Unless an alleged breach of trust obtains enough media attention to achieve political salience, actual scrutiny of a charitable trust by the attorney general is unlikely. In the usual case there is not enough of a political payoff to the attorney general to warrant the diversion of resources from other initiatives. The mirror-image worry is that when the attorney general does intervene in response to political pressure, he or she will be tempted to promote his or her political interests at the expense of the trust’s charitable purpose. Dissatisfaction with supervision of charitable trusts by state attorneys general has led to a reconsideration, in accordance with freedom of disposition, of the rule against settlor standing.<sup>89</sup>

## XII. TRUSTS: POWERS OF APPOINTMENT

Earlier we considered trusts in which the settlor preserves flexibility by giving the trustee fiduciary discretion over future distributions of trust property. The settlor may also give to someone other than the trustee a nonfiduciary power to distribute trust property. Such a power is known as a

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88. This discussion draws on Jonathan Klick & Robert H. Sitkoff, *Agency Costs, Charitable Trusts, and Corporate Control: Evidence from Hershey’s Kiss-off*, 108 COLUM. L. REV. 749, 781–82 (2008).

89. See UNIF. TRUST CODE § 405(c).



*power of appointment*. The holder of a power of appointment, known as the *donee*, may appoint the property to one or more persons, known as the *objects*, in accordance with the terms of the power.

Consider a typical example: *H* devises property to *X* in trust to distribute the income quarterly to *W* for life, and on *W*'s death to distribute the principal to one or more of *H*'s descendants as *W* shall appoint in her will. *H* is the *donor* of a power of appointment, *W* is the *donee*, and *H*'s descendants are the objects. By this power, which *W* holds in a nonfiduciary capacity, *W* may decide who among *H*'s descendants will take the trust property at her death. In this way, *H* empowers *W* to deal flexibly with changing circumstances in the interim between their deaths, which may span years or even decades. *W* can take into account births, deaths, marriages, and divorces; the evolving ability of children and more remote descendants to manage property; changes in the economy and investment returns; changes in the law; and other circumstances that *H* could not have foreseen but that *W* will observe firsthand.

Powers of appointment provide benefits beyond building *flexibility* into an estate plan. They are also commonly used for *tax planning* and *asset protection*. In the example given in the prior paragraph, because *W* cannot appoint the trust property for her own benefit, no estate or gift tax will be due upon *W*'s exercise of the power, and no creditor of *W* will have recourse against the property. It would be difficult to overstate the importance of powers of appointment in contemporary estate planning, that is, in the practical implementation of the donor's freedom of disposition.

### XIII. TRUSTS: CONSTRUCTION AND FUTURE INTERESTS

The Anglo-American system of *estates and future interests* allows a donor extraordinary latitude in crafting a transfer of property to be shared by multiple beneficiaries across time. Several generations ago, law schools commonly required a course on the subject. In those days, most future interests were given outright, that is, they were legal. Today, future interests almost always arise in trusts, that is, they are *equitable*. In expanding, trust practice has annexed the law of estates and future interests, transforming it into a question of drafting and construing trust instruments.

Consider a simple example: suppose *O* wants to give certain property to his children and then down the generations. In the past, *O* might have given a life estate in the property to his children, a remainder for life to his grandchildren, and so on, for as long as the Rule Against Perpetuities would allow. Today, this transfer is almost always made in trust. Lawyers who deal with trusts must therefore be familiar with the law of future interests, including common constructional and other problems with their use.

The core conceptual idea underlying the law of future interests is that a *future interest* is itself a form of property. The owner of a future interest may

transfer *it*. Creditors may seize *it*. At the owner's death, *it* passes in probate or by will substitute. What distinguishes a future interest from a *present interest* is that the owner of a future interest does not have a current right to *possession or enjoyment* of the property.

The question in trust practice is how to tailor future interests to achieve a settlor's intent and how to avoid intent-defeating technical rules and common problems caused by ambiguous language. Although the law of future interests provides tremendous flexibility in multigenerational gratuitous transfers, some of the rules in this area are relics of medieval feudalism that can wreck a dispositive plan if the drafter is not alert to them.<sup>90</sup>

#### XIV. THE RULE AGAINST PERPETUITIES AND TRUST DURATION

Freedom of disposition, the organizing principle of the American law of succession, is as we have seen not absolute. Perhaps the most storied policy limit on freedom of disposition is the *Rule Against Perpetuities*. Along with two related doctrines that also curb the reach of the dead hand—the *rule against suspension of the power of alienation* and the *rule against accumulations of income*—the Rule Against Perpetuities is the main constraint on trust duration.

The Rule Against Perpetuities requires all interests, whether in trust or otherwise, to vest or fail within the lives of everyone who could possibly have been known to the donor (“lives in being”) plus the minority of the next generation (“plus twenty-one years”).<sup>91</sup> Sir Arthur Hobhouse famously explained the rationale for this period thus:

A clear, obvious, natural line is drawn for us between those persons and events which the Settlor knows and sees, and those which he cannot know or see. Within the former province we may trust his natural affections and his capacity of judgment to make better dispositions than any external Law is likely to make for him. Within the latter, natural affection does not extend, and the wisest judgment is constantly baffled by the course of events.<sup>92</sup>

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90. See Lawrence W. Waggoner, *Reformulating the Structure of Estates: A Proposal for Legislative Action*, 85 HARV. L. REV. 729, 729–32 (1972); see also D. Benjamin Barros, *Toward a Model Law of Estates and Future Interests*, 66 WASH. & LEE L. REV. 3, 4 (2009); T.P. Gallanis, *The Future of Future Interests*, 60 WASH. & LEE L. REV. 513, 514 (2003).

91. The classic formulation comes from JOHN CHIPMAN GRAY, *THE RULE AGAINST PERPETUITIES* § 201, at 191 (Roland Gray ed., 4th ed. 1942): “No interest is good unless it must vest, if at all, not later than twenty-one years after some life in being at the creation of the interest.”

92. ARTHUR HOBHOUSE, *THE DEAD HAND: ADDRESSES ON THE SUBJECT OF ENDOWMENTS AND SETTLEMENTS OF PROPERTY* 188 (1880).

Property cannot be subjected to contingencies for longer than the perpetuities period. In this way, the Rule imposes a time limit on freedom of disposition and so the reach of the dead hand.

The Rule Against Perpetuities is said to have two main purposes: (1) keeping property marketable, and (2) limiting dead hand control. Property cannot be conveyed with clear title unless all persons with an interest in the property agree to the conveyance. By requiring that the identity of all persons with a claim on property be ascertained within the perpetuities period, the Rule ensures that the property will become marketable periodically. The second purpose, limiting dead hand control, is perhaps best understood in light of the disagreeable consequences that can arise from property arrangements made obsolete by changes in circumstances. By forbidding contingencies that might remain unresolved beyond lives in being plus twenty-one years, the Rule puts an outer boundary of roughly 100 years or so on the temporal reach of the dead hand.

Although there may still be consensus in favor of the underlying policy aims of the Rule Against Perpetuities, its particulars have come under attack. At common law, any interest that might not vest or fail within the perpetuities period was void from the outset no matter how implausible the invalidating possibility. "It is at this point that the rule becomes a trap to the draftsman. Many perfectly reasonable dispositions are stricken down because on some outside chance not foreseen by the testator or his lawyer it is mathematically possible that the vesting might occur too remotely."<sup>93</sup> The *fertile octogenarian*, *unborn widow*, and other such infamous absurdities that have brought the Rule into disrepute are products of the merciless and unyielding logic of the common law Rule.

Today, every state has reformed the Rule in one way or another. Many of these reforms, such as the wait-and-see doctrine, are meant to honor the Rule's basic purpose, but not all. Most strikingly, as a consequence of the competition across the states for trust business, more than half the states have abrogated the Rule to allow for a *perpetual trust*.<sup>94</sup> As a consequence, "Congress has come to be in charge of trust duration. The future of perpetual trusts is in its hands, to be dealt with through the tax system."<sup>95</sup>

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93. W. Barton Leach, *Perpetuities in a Nutshell*, 51 HARV. L. REV. 638, 643 (1938).

94. See, e.g., Robert H. Sitkoff & Max M. Schanzenbach, *Jurisdictional Competition for Trust Funds: An Empirical Analysis of Perpetuities and Taxes*, 115 YALE L.J. 356 (2005).

95. Jesse Dukeminier & James E. Krier, *The Rise of the Perpetual Trust*, 50 UCLA L. REV. 1303, 1343 (2003).

## XV. WEALTH TRANSFER TAXATION

Probably the most important limitation on freedom of disposition in contemporary practice is the federal wealth transfer tax system: the *gift*, *estate*, and *generation-skipping transfer* taxes of the Internal Revenue Code.

In the early history of the United States, death taxes were levied only temporarily during times of urgent need for revenue such as war. The estate tax as we know it today did not appear until World War I, to finance that war, but Congress chose not to repeal the tax when the fighting stopped. The tax was retained in part in response to public hostility toward the enormous family fortunes. During the Great Depression, President Franklin D. Roosevelt captured the mood of the country when he declared:

The desire to provide security for one's self and one's family is natural and wholesome, but it is adequately served by a reasonable inheritance. Great accumulations of wealth cannot be justified on the basis of personal and family security. In the last analysis such accumulations amount to the perpetuation of great and undesirable concentration of control in a relatively few individuals over the employment and welfare of many, many others. Such inherited economic power is as inconsistent with the ideals of this generation as inherited political power was inconsistent with the ideals of the generation which established our Government.<sup>96</sup>

The debate over the principle of freedom of disposition, and its role in perpetuating inequalities of wealth, is today a question of federal tax policy.

In 1932, Congress added the gift tax to prevent avoidance of the estate tax (and the income tax) through inter vivos transfers to children and others.<sup>97</sup> In 1976, the gift and estate tax systems were unified, so that one rate schedule applied to cumulative gratuitous transfers in excess of a threshold amount, whether the transfer was inter vivos or testamentary. In 1986, to ensure a wealth transfer tax at each generation, Congress enacted the generation-skipping transfer tax.

The expansion of the federal wealth transfer tax system shifted into reverse in 2001, when Congress passed legislation that phased out the estate tax by raising the threshold for taxation and lowering the tax rate over the following nine years. In 2001, estates in excess of \$1 million were taxed at a rate of 55 percent. By 2010, the estate tax disappeared entirely, making 2010 a tax-efficient year in which to die.<sup>98</sup> The 2001 legislation had a sunset clause,

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96. H.R. REP. NO. 74-1681, at 2 (1935).

97. See Jeffrey A. Cooper, *Ghosts of 1932: The Lost History of Estate and Gift Taxation*, 9 FLA. TAX REV. 875, 879 (2010).

98. There is some evidence that death is tax sensitive. Two studies have found changes in death rates around the time of changes in estate tax rules such that living longer or dying sooner would have a substantial tax consequence. As the authors of these studies concede, however, it is

however, so that in 2011 the estate tax would return to its 2001 level. But late in 2010, before that clause took effect, Congress passed superseding legislation that imposed a 35 percent tax in 2011 and 2012 on estates in excess of \$5 million (indexed for inflation). Like the 2001 legislation, the 2010 legislation had a sunset clause so that in 2013 the estate tax would return to its 2001 level.<sup>99</sup> But then on New Year's Day 2013, Congress made permanent an estate tax on estates in excess of \$5 million (indexed for inflation) at a rate of 40 percent.<sup>100</sup> As of this writing in 2014, the inflation-adjusted threshold for taxation is \$5.34 million.

The federal wealth transfer taxes do not generate much revenue. In fiscal year 2012, the estate tax raised \$12.3 billion, and the gift tax raised \$2.1 billion, for a total of roughly \$14.4 billion—akin to a rounding error in the total \$2.5 trillion in internal revenue collected by the federal government in that year.<sup>101</sup> Even when rates were higher and the threshold amount for taxation was lower, the total take was quite modest.

Critics argue that wealth transfer taxes are more trouble than they are worth, that in effect they are a lawyer tax on the wealthy that distorts lifetime savings and consumption while dulling useful incentives toward productivity. Supporters counter that, even if these taxes do not raise much revenue, they nonetheless add progressivity to the overall tax system, prevent plutocracy, make up for holes in the income tax (in particular for unrealized capital gains<sup>102</sup>), and encourage charitable giving.<sup>103</sup> Viewed in this manner, the

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possible that some of the observed changes in death timing could reflect tax-motivated fraud in the reporting of the death date. See Joshua S. Gans & Andrew Leigh, *Did the Death of Australian Inheritance Taxes Affect Deaths?*, 6 TOPICS ECON. ANALYSIS & POL'Y 1, 1 (2006); Wojceich Kopczuk & Joel Slemrod, *Dying to Save Taxes: Evidence from Estate-Tax Returns on the Death Elasticity*, 85 REV. ECON. & STAT. 256, 264 (2003).

99. Why the sunset clauses, necessitating fresh legislation every few years? See Edward J. McCaffery, *The Dirty Little Secret of (Estate) Tax Reform*, 65 STAN. L. REV. ONLINE 21, 23 (2012).

100. See The American Taxpayer Relief Act of 2012, Pub. L. No. 112-240, 126 Stat. 2313 (2013).

101. These figures are derived from estimates by the Statistics of Income Division of the IRS, per the 2012 Excel table found at *SOI Tax Stats—Gross Collections by Type of Tax—IRS Data Book Table 6*, IRS, <http://www.irs.gov/uac/SOI-Tax-Stats-Gross-Collections-by-Type-of-Tax-IRS-Data-Book-Table-6> (last visited Nov. 14, 2013).

102. See James M. Poterba & Scott Weisbenner, *The Distributional Burden of Taxing Estates and Unrealized Capital Gains at Death*, in RETHINKING ESTATE AND GIFT TAXATION 422, 450 (William G. Gale, James R. Hines, Jr. & Joel Slemrod eds., 2001).

103. See JOEL SLEMROD & JON BAKIJA, TAXING OURSELVES 297 (3d ed. 2004); see also Louis Kaplow, *On the Taxation of Private Transfers*, 63 TAX L. REV. 159, 185 (2009); Anne L. Alstott, *Equal Opportunity and Inheritance Taxation*, 121 HARV. L. REV. 469, 492 (2007); James R. Repetti, *Democracy, Taxes, and Wealth*, 76 N.Y.U. L. REV. 825, 854 (2001); Edward J.

debate over transfer tax policy is a debate over the proper scope of freedom of disposition, the implementation of which is the object of the law of succession.